

NATIONALIZATION OF PUBLIC UTILITIES IN BRAZIL

by

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Dear Professor Franklin:

In accordance with the requirements for the degree of Master of Science in Industrial Management, I herewith submit a thesis entitled "Nationalization of Public Utilities in Brazil."

At this time, I would like to acknowledge the valuable and patient counseling provided me by Messrs. Richard Dunlop Robinson and John Daniel Nyhart of the Alfred P. Sloan School of Management.

In addition, I am indebted to Mr. Marvin S. Fink of American & Foreign Power Company Incorporated and Mr. Francis J. Harkins of International Telephone and Telegraph Corporation for the invaluable information they provided me with or directed me to, without which this thesis would not have been possible.

Sincerely yours,

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January 18, 1965

An Abstract of:

NATIONALIZATION OF PUBLIC UTILITIES IN BRAZIL

by

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A thesis submitted to the Alfred P. Sloan School of Management of Massachusetts Institute of Technology on January 18, 1965, in partial fulfillment of the requirements for the degree of Master of Science in Industrial Management.

This thesis relates and examines recent Brazilian moves to nationalize public utilities providing electric light and power and telephone services in Brazil. Primary attention is focused on available English language materials relating to utility operations prior to the nationalization moves. It is found that nationalization of the utilities was the logical step in Brazilian utility policy.

Electric light and power and telephone utilities in Brazil were dominated by two United States firms--International Telephone and Telegraph Corporation and American & Foreign Power Company Incorporated--and one Canadian firm--Brazilian Traction, Light and Power Company, Limited. Brazilian regulatory policy limited the return to investment in utilities to a fixed percentage of the historical value of the investment less depreciation. Hence, while making provision for increased operating expenses, the regulatory policy made no allowance for the decline of the real value of legal profits of the utilities through inflation. Consequently, utility services deteriorated so as to imperil the Brazilian economy, arousing popular opposition to the utilities and requiring government attention to the problem. Restoration of profitability to the utilities through rate increases was not politically expedient because of growing nationalism and popular hostility toward foreign capital and the foreign-owned utilities in particular. In order to halt the deterioration of services, the only alternative for Brazilian policy was to nationalize the foreign-owned utilities in accordance with nationalistic demands.

The first moves to nationalize the foreign-owned utilities came from nationalistic state governors. This made international relations difficult for the Federal Government of Brazil, forcing its intervention into expropriation cases.

It subsequently announced the Goulart Plan in 1962 whereby the Federal Government would negotiate the purchase of the foreign-owned utilities, requiring most of the proceeds to be reinvested in other sectors of the Brazilian economy. The Plan is now being carried out, but nationalization is presently far from complete.

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CHAPTER I

INTRODUCTION TO NATIONALIZATION OF PUBLIC UTILITIES IN BRAZIL

Rio de Janeiro, city of delights;
By day there is no water,
At night there are no lights.¹

This verse from a 1955 carnival song depicts, lightheartedly, the quality of utility services provided by foreign capital in Brazil. Not so lightheartedly, Brazil is nationalizing foreign-owned utilities, because popular opinion and economic necessity have demanded remedial action.

I. LATIN AMERICAN TRENDS TOWARD NATIONALIZATION OF PUBLIC UTILITIES

Nationalization of utilities has occurred in other Latin American nations besides Brazil. For example, Mexico recently purchased the electric power subsidiaries of American & Foreign Power Company Incorporated, a United States firm, and is moving toward nationalization of the entire electric power industry. In Argentina, between 1944 and 1952, sixty-one electric power plants that served 107 localities and belonged to forty-seven companies were expropriated, many without compensation. Since 1952, additional expropriations have been made in the electric power industry, and the

¹"Darkness in Rio," Time, 81:45, May 24, 1963.

Government of Argentina has made arrangements to acquire a large portion of the industry remaining in private hands.² In both Colombia and Venezuela, American & Foreign Power Company recently signed contracts for the sale of its electric power subsidiaries to the respective governments.³ In Cuba, all utilities, mostly those of American & Foreign Power Company and International Telephone and Telegraph Corporation of New York, were expropriated without compensation in 1960.⁴

With the exception of Cuba, where different circumstances are readily apparent because of the Communist revolution there, the central issues in the above mentioned cases have been governmental regulatory policies that were either indifferent or hostile to the needs of private investors in public utility operations. Latin American nations, often in response to popular demands, generally have fixed utility prices below those that would be required to generate reasonable profits and funds for expansion.⁵ Services, as a result, have deteriorated so as to encourage government

²Herbert Bratter, "Latin American Utilities' Nationalization Proceeds Inexorably," Public Utilities Fortnightly, 66:1-15, July 7, 1960.

³American & Foreign Power Company Incorporated, Annual Report 1963 (New York: American & Foreign Power Company Incorporated, 1964), pp. 8-10.

⁴"Brazil Leads Drive on Foreign Utilities," Business Week, April 14, 1962, pp. 37-38.

⁵David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), 257 pp.

intervention. As an example of the political nature of the problem, in 1960, the Colombian Government and American & Foreign Power Company agreed to a higher rate structure for electric power. But, when the Company sent out the bills at the higher rates, mobs rioted in one city, burned the Colombian counterpart of "Ready Kilowatt" in effigy, and threw rocks at the Company's offices. The rate increases were rescinded by the Government, and American & Foreign Power Company offered its properties for sale.⁶

In terms of the general trend of events in Latin America, the Brazilian experience is only part of the total picture. However, this study will concentrate only on developments in Brazil, except in the concluding chapter where the relevance of these other events will be considered.

II. OBJECTIVE OF STUDY

The original objective of this thesis was to examine, in depth, the expropriation of a subsidiary of the International Telephone and Telegraph Corporation by the Brazilian State of Rio Grande do Sul on February 16, 1962. This incident attracted considerable attention in the United States, because Latin American actions of this variety were considered to be a threat to the effectiveness of the widely publicized Alliance for Progress program in attracting new investment capital in Latin America. It was felt that

⁶"A U. S. Company in a Latin Squeeze," Fortune, 65:101-3 ff., February, 1962.

examination of this case would add to understanding about problems and risks of international business operations.

There were serious limitations to this objective. First, real information, besides the superficial newspaper accounts, was not readily available, because International Telephone and Telegraph Corporation did not want to reveal internal operating data while final settlement of the case was pending in the Brazilian courts. Second, a superficial examination of the circumstances surrounding the case revealed that, out of the context of other developments in Brazil, the real significance of the case was obscured. For example, there was the Rio Grande do Sul expropriation of an electric light and power utility owned by American & Foreign Power Company in 1959. In addition, in 1962, there were a series of expropriation attempts in other states in Brazil and the announcement of the Goulart Plan whereby the Federal Government of Brazil would negotiate the purchase of all foreign-owned utilities.

Hence, by necessity, the research for this thesis turned toward obtaining information on these other developments. While there were limitations on information blocking the exploration of any one of these cases in depth, there was a relative abundance of information relating these cases to the broader picture. Indeed, the real significance of each of these cases lies in its relationship to this broader sweep of events.

III. MERITS OF STUDY

A study of the factors behind the recent nationalization developments in Brazil has value from several points of view. From the standpoint of international business operations, such a study has merit in adding to the understanding of those factors affecting the risks of foreign operations. From an historical point of view, it contributes to the understanding of political developments in Brazil. And, from the point of view of international relations, it contributes to the understanding of factors that sometimes make foreign relations difficult.

IV. SCOPE AND FINDINGS

This thesis relates and examines the role of electric light and power and telephone utilities in the Brazilian economy; the regulatory system under which they operated; the financial position of the utilities and its effect on the services they provided; the social, political, and economic developments in Brazil associated with or affecting the operations and risks of these utilities; and the recent nationalization developments in order to determine the reasons for the recent nationalization moves. Since foreign capital dominated utilities in Brazil, the primary focus of this study is on the foreign-owned utilities. However, the problems of Brazilian-owned utilities are examined as well in order to place events in their proper

perspective. In summary, it is found that nationalization of the utilities, especially the foreign-owned utilities, is the only feasible alternative for Brazilian utility policy under present conditions, and, consequently, that nationalization is the logical consequence of utility developments in Brazil.

V. DEFINITIONS OF TERMS

In order to avoid possible future confusion, certain concepts used throughout this thesis should be defined. First, references to utility or utilities means only electric light and power or telephone utilities, unless otherwise specified. Transportation, water, gas, and other services commonly regarded as utility services are not under consideration here, except in occasional passing references. Second, the term nationalization, or other forms of the word, means the transfer of the ownership of property held by private citizens, domestic or foreign, to governmental agencies. It is important to note that this definition, which is the commonly used one, does not specify by what means the transfer was accomplished. Third, the term expropriation, or other forms of the word, means the sovereign act of taking away, unilaterally, the property rights held by private citizens, domestic or foreign.

The distinction between nationalization and expropriation should be noted. An act of expropriation--whereby the

governmental authorities seize the property from the owner, with or without compensation--is an act of nationalization. However, nationalization can be achieved through other means as well, such as by negotiated purchase with the owner. Thus, the converse may not be true; an act of nationalization may not be an act of expropriation. In this thesis, any specific event involving seizure of private property will be termed as an act of expropriation. Any specific event involving the negotiated transfer of the property from private to governmental hands will be termed as an act of nationalization, with the fact that negotiated purchase was involved specified. Any series of events involving both seizure and purchase will be termed as nationalizations.

VI. LIMITATIONS OF STUDY

There are limitations to this study. First, source material has been limited to that written in, or translated into, English. Undoubtedly, much additional information is available in Portuguese. In terms of the amount of information available for study, this limitation has not proved to be of great consequence. However, some source materials, especially those appearing in periodical literature, contained bias favoring the foreign-owned utilities. In these instances, caution has been used in interpreting these sources in order to preserve objectivity in the analysis of

factual information. The effect of this limitation has been to restrict the freedom of this study in probing certain aspects of the Brazilian situation.

Second, examination of the aggregate utility picture in Brazil necessarily limits the exploration in depth of various factors such as economic, social, or political ones. This thesis examines such factors only to the extent required to understand the nationalization developments, and the reader who is looking for a comprehensive study of certain factors--such as Brazilian politics, for example--will not find it here.

VII. ORGANIZATION OF MATERIAL

The bulk of this thesis will relate and examine factual information relevant to the nationalization developments in Brazil. Interpretation and analysis of the situation and the alternatives facing utilities in Brazil and the Brazilian Government will, for the most part, be confined to the concluding chapter. For example, in the first part of this introductory chapter, reference was made to nationalization developments in other Latin American nations. The significance of developments such as these in shaping strategies or alternatives for the foreign-owned utilities will be examined in the final chapter where it is most convenient to relate all the factors to the entire picture.

Chapter II of this thesis will introduce the foreign-owned utilities in Brazil and reveal the nature of their

dominance in the Brazilian infrastructure and the risks inherent in such a position. Chapter III will describe the regulatory provisions of Brazilian law that affected utility operations, particularly the provisions that made no allowance for the decline of the real value of the return to utility capital through inflation. Chapter IV will show that, as a result, profits declined, discouraging new investment in utilities and causing the gradual deterioration of utility services. Chapter V will show that economic and social changes in Brazil have contributed to growing nationalism and hostility toward foreign capital, thereby making it politically impossible for popularly elected leaders to restore profitability to the utilities, and leaving the leaders no choice other than nationalizing utilities in order to halt the continued deterioration of services. Chapter VI will relate and discuss the nationalization moves up to the time of the writing of this thesis. Chapter VII will summarize and integrate the findings of previous chapters, examine the strategies available to the utilities and the Brazilian Government, and demonstrate that nationalization was the only feasible alternative for Brazilian utility policy.

VIII. REVIEW OF SOURCES

This thesis is not the first study of Brazilian utility problems. Other authors have examined utility operations

and problems in Brazil in greater depth than presented here.⁷ This thesis updates those sources, where appropriate for our purposes, and relates the utility situation in Brazil to recent nationalization moves and the political climate that brought them about. Previous studies in depth were made before the recent nationalization moves, and, therefore, did not examine the impact the utility situation had on government policy.

The sources cited in the previous footnote are supplemented with information obtained from accounts in periodical literature, documents from American & Foreign Power Company and International Telephone and Telegraph Corporation, personal interviews with officials of those companies conducted by the author, and standard library references.

⁷David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959); Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960); Joint Brazil-United States Economic Development Commission, The Development of Brazil (Washington: U. S. Government Printing Office, 1954).

CHAPTER II

ORGANIZATION OF UTILITIES IN THE BRAZILIAN ECONOMY

The public utility problems in Brazil are not new. Their genesis lies in the development of public utility services and concomitant regulatory laws. The purpose of this chapter is to present, briefly, a sketch of utility development in Brazil, especially the development of foreign-owned utilities, and the significance of this development for the Brazilian economy. As mentioned in Chapter I, the discussion will be confined primarily to electric light and power utilities.

I. UTILITY OWNERSHIP IN THE AGGREGATE

Prior to the moves toward nationalization, public utilities, especially those providing telephone services and electric power, were owned primarily by aliens. Three major foreign companies were involved in telephone operations. According to 1958 figures, a year which does not reflect the distortions of recent expropriations, there were 928,117 telephones in service in Brazil.¹ Of these,

¹Statistical Yearbook 1961 (New York: United Nations, 1961), p. 398.

67,374,² or roughly 6.7 percent of the total, were provided by an operating subsidiary of the International Telephone and Telegraph Corporation (ITT), of New York. Subsidiaries of Brazilian Traction, Light and Power Company, Limited (Brazilian Traction), of Canada, furnished 729,857 telephones,³ or roughly 80 percent of the total. The remainder of the telephones in service were supplied by subsidiaries of American & Foreign Power Company Incorporated (AMFORP), of New York, and more than 250 other municipal or privately owned companies in other localities.⁴ Thus, in the vicinity of 90 percent of the country's telephones were supplied by foreign companies.

A statistical count of the number of telephones in service reflects, of course, only the extent of local control; it does not reveal ownership of long distance channels of communications. In fact, ITT now dominates radio-telephone service within the country,⁵ and handles more than 90 percent of the telephone service between Brazil and the

²Moody's Industrial Manual 1963 (New York: Moody's Investor Service, Incorporated, 1963), pp. 2583 ff.

³Moody's Public Utility Manual 1963 (New York: Moody's Investor Service, Incorporated, 1963), pp. 1714 ff.

⁴United States Department of Commerce, Brazil (Washington: U.S. Government Printing Office, 1961), p. 142.

⁵Ibid.

United States.⁶

Two of the same three companies were dominant in the supply of electric power in Brazil. According to 1958 figures, subsidiaries of Brazilian Traction accounted for 43 percent of the installed generating capacity and 51 percent of the total electrical production in Brazil. Subsidiaries of AMFORP accounted for 11 percent of the installed capacity and 12 percent of the total electrical production. The balance was accounted for by public companies, 14 percent of the installed capacity and 11 percent of the total production; private companies, 23 percent of the installed capacity and 18 percent of the total production; and industrial self-producers, 9 percent of installed capacity and 8 percent of the total production.⁷ Thus, foreign-owned power companies accounted for 54 percent of the country's installed capacity and 63 percent of the total production of electric power. Table I, below, gives the data for installed capacity and total production in Brazil for 1955 and 1958.

⁶International Telephone and Telegraph Corporation, Annual Report 1963 (New York: International Telephone and Telegraph Corporation, 1964), p. 23.

⁷United States Department of Commerce, op. cit. p. 110.

TABLE I

INSTALLED GENERATING CAPACITY AND NET ENERGY PRODUCTION
IN BRAZIL, 1955 AND 1958

COMPANY	INSTALLED CAPACITY thousands of kilowatts		ENERGY PRODUCTION millions of kilowatt-hours	
	1955	1958	1955	1958
Brazilian Traction, Light and Power Company, Ltd.	1,462	1,673	6,509	8,871
American & Foreign Power Company, Incorporated	318	422	1,383	2,036
Principal public companies:				
Centrais Eletricas de Minas Gerais	64	172	148	745
Companhia Hidroeletrica de Sao Francisco	202	202	244	603
Comissao Estadual de Energia Eletrica do Rio Grande do Sul	83	135	232	513
State-controlled power companies, Sao Paulo	--	51	---	30
Subtotal	349	560	624	1,891
Other companies	702	880	2,460	3,080
Private industrial production	317	365	1,123	1,440
Total	3,148	3,900	12,099	17,318

Source: United States Department of Commerce, Brazil.
(Washington: U.S. Government Printing Office, 1961), p. 110.

Foreign investment in Brazilian utilities has accounted for a significant portion of the total investment in Brazil. According to 1959 estimates, foreign capital had supplied roughly 31 percent of the total public and private investment in Brazil. Of the foreign share, 17.7 percent had come from Canada, and 37.5 percent had come from the United States. Nearly 100 percent of the Canadian portion represented investment by Brazilian Traction, and roughly 23 percent of the United States portion represented investment by ITT and AMFORP. Based on these figures, foreign investment in utilities in Brazil up to 1959 had accounted for roughly 8 percent⁸ of the total public and private investment in that country.

The figures cited reveal the preponderance of foreign ownership in the telephone and electric power utilities in Brazil. For this reason, it is useful to explore, briefly, the history of each of the three foreign-owned utilities and their role in the Brazilian economy. In order to maintain perspective, public and private Brazilian-owned utilities will be described as well. A discussion of utility investment and growth will be deferred until Chapter IV, where factors affecting investment and growth will be introduced.

In the following discussion, frequent mention will be made of various geographical locations in Brazil. The map

⁸United States Department of Commerce, op. cit., pp. 11-14.

of Brazil below, Figure 1, shows the major locations that will be mentioned.

II. BRAZILIAN TRACTION, LIGHT AND POWER COMPANY, LIMITED

Brazilian Traction, Light and Power Company, Limited (Brazilian Traction), the largest utility in Brazil, was incorporated in Canada in 1912 to consolidate by exchange of stock the facilities of the Sao Paulo Electric Company, Limited; the Rio de Janeiro Tramway, Light & Power Company, Limited; and the Sao Paulo Light and Power Company, Limited - all Canadian firms.⁹

According to January, 1954 figures, 51 percent of the common stock of Brazilian Traction was held in Canada, 15 percent was held in the United Kingdom, 8 percent was held in the United States, 1 percent was held in various other countries, and 25 percent was held in bearer share warrants with addresses unknown.¹⁰

Brazilian Traction is a holding company with all physical property owned by subsidiaries in Brazil. Operations are concentrated in the southeastern States of Brazil, the country's most populous and developed area. The company supplies electric light and power and telephone services in the City

⁹Moody's Public Utility Manual 1963, op. cit., p. 1712.

¹⁰Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960), p. 50.

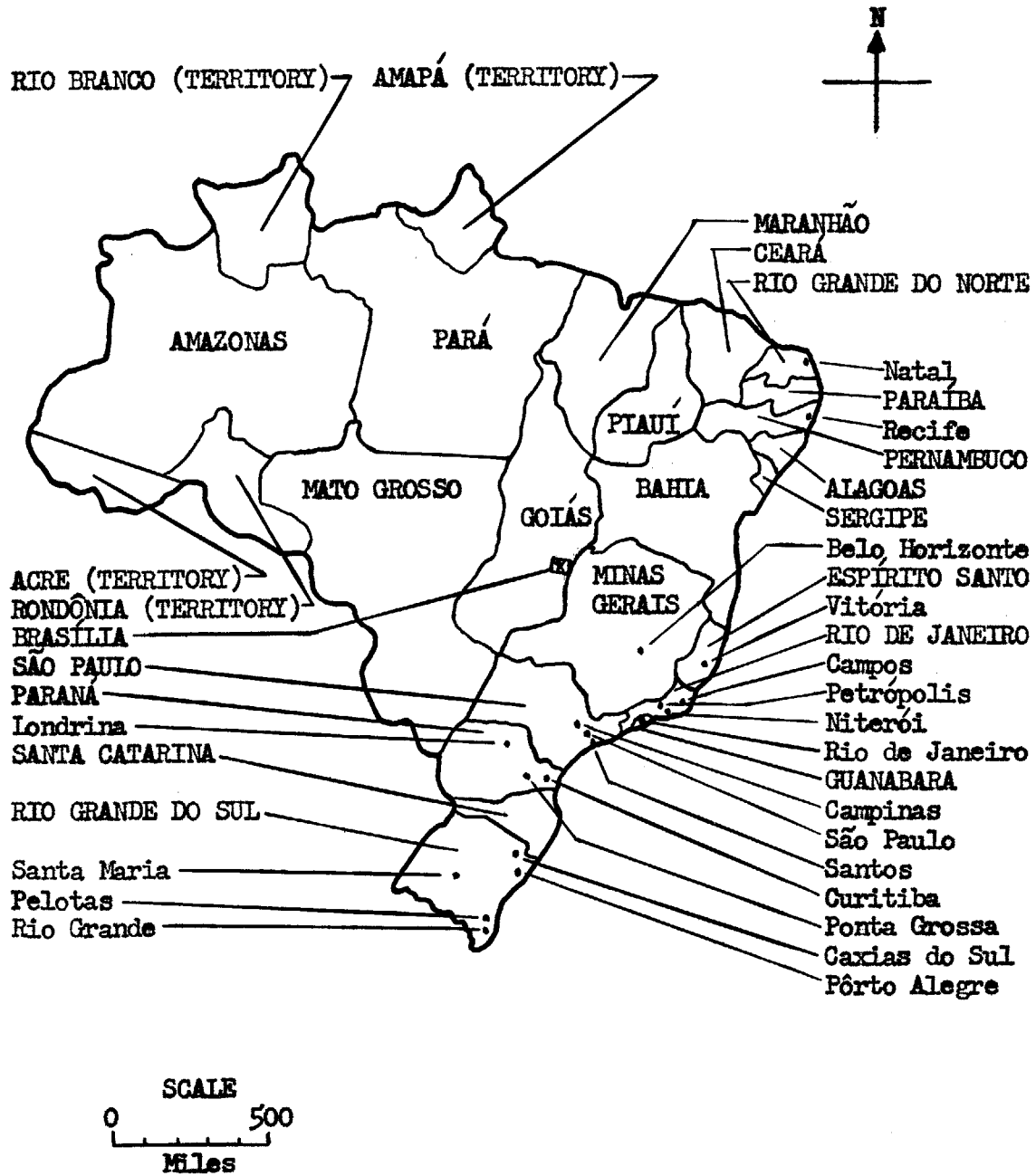


FIGURE 1

MAP OF BRAZIL SHOWING LOCATIONS CITED

of Rio de Janeiro and in the more populous areas of the States of Rio de Janeiro and Sao Paulo. Telephone service is supplied in parts of the States of Espirito Santo and Minas Gerais. In the Cities of Santos and Sao Paulo, gas is manufactured and distributed. Tramway lines are operated in some parts of these same areas mentioned.¹¹

In 1940, Brazilian Traction had nine operating subsidiaries providing tramway, bus, gas, water, electric light and power, and telephone services.¹² In 1960, the same services, with the exception of water, were provided through sixteen operating subsidiaries.¹³ Comparative figures for the years 1939 and 1959 reveal the extent of the company's involvement and growth in Brazil over that period. Statistics are given in Table II below for the various services provided and the book values of investments and earnings.

From Table II, it can be seen that Brazilian Traction's involvement in tramway service and water supply has been declining. This reflects early trends of local governmental activity in taking over such municipal services. For example, prior to termination of certain concessions, some years ago, Brazilian Traction also supplied water in the City of Santos

¹¹Moody's Public Utility Manual 1960 (New York: Moody's Investor Service, Incorporated, 1960), pp. 1375 ff.

¹²Moody's Public Utility Manual 1940 (New York: Moody's Investor Service, Incorporated, 1940), pp. 2005 ff.

¹³Moody's Public Utility Manual 1960, loc. cit.

TABLE II

CONSOLIDATED OPERATING STATISTICS FOR BRAZILIAN TRACTION, LIGHT AND POWER
COMPANY, LIMITED, FOR 1939 AND 1959

	1939	1959
Passengers carried	978,561,798	396,655,579
Tramway track miles	537	274
Electricity sales, Kilowatt-hours	1,555,197,493	8,422,799,704
Generating capacity, kilowatts	524,484	1,673,300
Gas Sales, cubic meters	144,480,023	11,318,107,717
Water Sales, cubic meters	12,213,149	---
Telephones in service	208,633	756,694
Operating Revenue, U. S. Dollars	37,199,350	150,963,316
Net income, U. S. Dollars	9,166,108	10,010,061
Book value of physical property, U. S. Dollars	269,624,092	954,463,421
Book value of total assets, U. S. Dollars	442,730,884	1,029,231,043

Source: Moody's Public Utility Manual 1940 (New York: Moody's Investor Service, Incorporated, 1940), pp. 2005 ff.; and Moody's Public Utility Manual 1960 (New York: Moody's Investor Service, Incorporated, 1960), pp. 1375 ff.

and tramway service in the cities of Santos, Sao Paulo,¹⁴ and Rio de Janeiro.¹⁵ The significance of developments such as these will be discussed in the concluding chapter of this thesis.

In concluding this brief sketch of Brazilian Traction, it should be noted that this company has had very little participation of Brazilian investors. According to 1953 figures, minority interest in subsidiaries amounted to only 0.6 percent of the total consolidated capitalization of Brazilian Traction and its subsidiaries.¹⁶

III. AMERICAN & FOREIGN POWER COMPANY INCORPORATED

American & Foreign Power Company Incorporated (AMFORP) was incorporated in Maine in 1923, and thereafter it acquired assorted utility enterprises in Central and South America. In 1929, it acquired an electric power system for the International Settlement in Shanghai, China, and a 50 percent interest in an electric power system in Bombay, India. The latter interest was sold in 1951,¹⁷ and the former was, of course, lost in 1950 to the Chinese Communists who had taken over Shanghai.¹⁸

¹⁴Ibid.

¹⁵Moody's Public Utility Manual 1963, op. cit., pp.1712 ff.

¹⁶Fink, loc. cit.

¹⁷Moody's Public Utility Manual 1960, op. cit., pp. 1185 ff.

¹⁸"How to Survive Foreign Expropriation," Business Week, June 1, 1963, pp. 86-88.

AMFORP is an offspring of the once mighty utility empire held by the Electric Bond and Share Company of New York. The Public Utility Holding Company Act of 1935 ended Electric Bond and Share activities as a holding company of United States utilities,¹⁹ and the company has since become an investment firm holding 52.3 percent of AMFORP's common stock.²⁰

As stated in its Certificate of Organization, AMFORP's objects are those of a holding company, with the power to acquire securities and stocks of other companies and to render companies in which it is interested financial and other services. The stated primary policy of the company was to acquire controlling interests in foreign utility enterprises and to consolidate those interests, where practicable, into larger operating units. AMFORP conducts its operations from its head offices in New York.²¹

At the end of 1959, over 99 percent of AMFORP's total investments were located in Latin America.²² Table III below outlines AMFORP operations in this area as of December 31, 1959.

AMFORP also supplied electric light and power, transportation, and water and ice in Argentina until properties there were turned over to the Argentine Government in 1958.²³ Cuban

¹⁹"A U.S. Company in a Latin Squeeze," Fortune, 65:101-3 ff., February, 1962.

²⁰Moody's Public Utility Manual 1960, loc. cit.

²¹Ibid.

²²Ibid.

²³Ibid.

TABLE III

LIST OF AMERICAN & FOREIGN POWER COMPANY INCORPORATED OPERATIONS IN LATIN AMERICA AS OF DECEMBER 31, 1959, AND ESTIMATED POPULATION OF COMMUNITIES SERVED

	ELECTRIC LIGHT AND POWER	TRANSPOR- TATION	GAS	TELE- PHONE	POPULATION IN AREAS SERVED
Brazil	X	X	X	X	7,464,800
Chile	X				2,681,000
Colombia	X				1,079,600
Costa Rica	X			X	447,300
Cuba	X		X		3,044,500
Ecuador	X				452,000
Guatemala	X				565,300
Mexico	X				3,633,400
Panama	X		X	X	307,600
Venezuela	X				947,500

Source: Moody's Public Utility Manual 1960 (New York: Moody's Investor Service, Incorporated, 1960), pp. 1185 ff.

properties--AMFORP's most profitable ones, accounting for roughly one-third of its total profits--were expropriated in 1960 without compensation.²⁴ Properties in Mexico, Colombia, and Venezuela were sold to the host governments in 1960, 1962, and 1964 respectively.²⁵

Thus, whereas Brazilian Traction confined its operations to Brazil and dominated telephone and electric light and power services there, AMFORP operations dominated nowhere in Latin America. Nonetheless, the latter constituted the largest foreign utility investment in the area, accounting for roughly 10 percent of all installed electrical capacity in Latin America in 1958.²⁶ At the end of 1959, consolidated assets of AMFORP were in excess of 1.2 billion dollars, all in utilities, serving a total population of 20,623,000 in 1,363 communities. Electric power and light output amounted to 9,392,883 kilowatt-hours, serving nearly three million customers. Telephones were provided for 54,552 customers. Gross income to AMFORP amounted to \$23,523,348; net income to \$8,787,394.²⁷

AMFORP began its operations in Brazil in 1926 by purchasing numerous small and scattered companies and

²⁴"A U. S. Company in a Latin Squeeze," loc. cit.

²⁵American & Foreign Power Company Incorporated, Annual Report 1963 (New York: American & Foreign Power Company Incorporated, 1964), pp. 8-10.

²⁶"A U. S. Company in a Latin Squeeze," loc. cit.

²⁷Moody's Public Utility Manual 1960, loc. cit.

interconnecting and consolidating them. For example, in the State of Sao Paulo, AMFORP integrated twenty separate power companies into one. In 1961, AMFORP's operating subsidiaries provided electric light and power service in the states of Sao Paulo, Rio de Janeiro, Parana, Bahia, Minas Gerais, Pernambuco, Espirito Santo, Rio Grande do Sul, Alagoas, and Rio Grande do Norte. Excluding the cities of Rio de Janeiro, Sao Paulo, Brasilia, and Porto Alegre (the 1959 expropriation of AMFORP's properties in this City will be discussed in Chapter VI and Chapter VII), AMFORP electric light and power subsidiaries served the most important cities of Brazil, including eight capitals in the states mentioned above. In addition, telephone service was rendered in Natal, tramway and launch service in Vitoria, and gas service in Recife.²⁸ Electric power generation, however, was the most important service supplied by AMFORP in Brazil, accounting for 98 percent of the total combined revenues of its subsidiaries in 1959.²⁹

At the end of 1959, there were ten associated companies carrying out these services.³⁰ A service company, Companhia Auxiliar de Empresas Eletricas Brasileiras, provided management and technical services for the operating subsidiaries.³¹

²⁸American & Foreign Power Company Incorporated sources in New York.

²⁹Moody's Public Utility Manual 1960, loc. cit.

³⁰Ibid.

³¹United States Department of Commerce, op. cit., p. 110.

From the name of this company, the AMFORP subsidiaries derived the name "Empresas Eletricas Group". In actual organization, AMFORP subsidiaries were owned by the Brazilian Electric Power Company, a holding company subsidiary of AMFORP incorporated in Florida and with offices in New York.³²

Comparative financial and operating statistics for the years 1940 and 1960 reveal the magnitude and growth of AMFORP in Brazil for that period (see Table IV below). The Table does not show data for services other than electric power and light, the data for these other services not being readily available since they accounted for only a small portion of AMFORP's total operations. However, the financial data relate to all operations. Only the book values of AMFORP's investment, reflecting both debt and equity, are shown. Additional debt and equity capital have been supplied to the AMFORP subsidiaries by other sources. A breakdown of other capital contributions for the same years as shown in Table IV is not available, but the nature of the consolidated capital structure can be seen from 1953 data. In that year, long term debt supplied by AMORP and other sources accounted for 49.5 percent of the total consolidated capitalization of the AMFORP subsidiaries, minority Brazilian interests in equity and surplus accounted for 16.5 percent, and AMFORP interests in equity and surplus accounted for 34.0 percent.³³

³²Fink, op. cit., p. 18.

³³Ibid., p. 57.

TABLE IV

AMERICAN & FOREIGN POWER COMPANY ELECTRICAL GENERATING
CAPACITY AND PRODUCTION FIGURES AND FINANCIAL STATISTICS
FOR ALL SERVICES IN BRAZIL FOR 1940 AND 1960

	1940	1960*
Installed generating capacity, Kilowatts	161,701	507,208
Total Power Sales including power purchased from outside system (millions of kilowatt-hours)	611	2,878
Book value of American & Foreign Power Company investments in Brazil, U.S. Dollars	103,791,000	147,360,000
Net income booked to American & Foreign Power Company after Brazilian taxes, U. S. Dollars	3,402,000	5,000,000

*Electrical production data for 1960 do not include that of electric power facilities in the City of Porto Alegre, which were expropriated in 1959.

Source: American & Foreign Power Company of New York.

IV. INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION

International Telephone and Telegraph Corporation (ITT) was incorporated in Maryland in 1920 as a holding company to conduct general telephone, telegraph, wireless, and cable services and other incidental business including the construction of facilities and equipment. Since that time, ITT has grown into a large and diversified company with total assets in excess of 1.2 billion dollars located in the United States, Europe, Latin America, and other areas. In the United States, ITT is a major manufacturer of electronic equipment, about 71 percent of which goes to the government.³⁴ ITT is not greatly involved in telephone and telegraph communications within the United States, but, in Europe and Latin America, it is a major manufacturer of telecommunications equipment, and, in Latin America, it is also extensively involved in operation of international channels of communication and local telephone services.³⁵

ITT first entered into the telephone business in Brazil in 1927 through the acquisition of a controlling interest in Companhia Telefonica Rio Grandense in the State of Rio Grande do Sul - a firm incorporated by local nationals in 1908 in Porto Alegre, capital of the State.³⁶ In 1950, Companhia

³⁴Moody's Industrial Manual 1963, op. cit., pp. 2580 ff.

³⁵"International Telephone and Telegraph," Forbes, 93:20-24, February 1, 1964.

³⁶International Telephone and Telegraph Corporation sources in New York

Telefonica Rio Grandense offices were transferred to the City of Rio de Janeiro and the company was renamed Companhia Telefonica Nacional (CTN).³⁷ According to 1961 figures, CTN supplied 48,152 telephones in 130 municipalities in Rio Grande do Sul through 137 central offices, and the company operated--under a group of municipal, state, and federal concessions--intrastate and interstate telecommunications.³⁸ The formation of CTN in 1950 brought telephone operations in the States of Rio Grande do Sul and Parana under common management and control. In the latter state, according to 1963 figures, ITT provided 32,326 subscriber stations.³⁹ In 1940, the total number of telephones provided by subsidiaries of ITT in these two states numbered 24,219.⁴⁰ By 1960, before any expropriations, ITT was providing 73,599 telephones,⁴¹ or, as mentioned previously, roughly 6.7 percent of the total telephones in service in Brazil.

In the decade following the acquisition of Companhia Telefonica Rio Grandense, ITT also established a

³⁷Moody's Industrial Manual 1963, loc. cit.

³⁸International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil (New York: International Telephone and Telegraph Corporation, 1962), pp. 5-6.

³⁹International Telephone and Telegraph Corporation, Annual Report 1963, op. cit., p. 25.

⁴⁰Moody's Public Utility Manual 1947 (New York: Moody's Investor Service, Incorporated, 1947), pp. 1023 ff.

⁴¹Moody's Industrial Manual 1963, loc. cit.

manufacturing facility, Standard Eletrica S.A. Standard Eletrica is now one of Brazil's largest industrial concerns, manufacturing primarily telecommunication equipment and various consumer items such as radio and television receivers.⁴²

In 1930, ITT organized Companhia Radio Internacional do Brasil to conduct an international radiotelegraph and telephone service.⁴³ Today, this company provides international radiotelephone, radiotelegraph, and telex services and domestic radiotelephone services. This facility handles more than 90 percent of the telephone traffic between the United States and Brazil, more than 50 percent of the traffic between Brazil and Europe, and 80 percent of the traffic between Brazil and other Latin American nations.⁴⁴

Valuations for ITT's utility properties in Brazil are not published. In the case of Companhia Telefonica Nacional (CTN) operations in the State of Rio Grande do Sul, the 1962 expropriation there brought to light a book value of approximately \$6,500,000 for that part of CTN, as of December 31, 1961. ITT claimed that the properties were worth \$10,000,000 in fair present value at the time of the expropriation.⁴⁵ A subsequent expropriation threat against CTN operations in the State of Parana in May of 1962--that is, the State

⁴²International Telephone and Telegraph Corporation, Annual Report 1963, loc. cit.

⁴³Moody's Public Utility Manual 1947, loc. cit.

⁴⁴International Telephone and Telegraph Corporation, Annual Report 1963, op. cit., pp. 23-25.

⁴⁵Moody's Industrial Manual 1963, loc. cit.

Governor announced that the act of expropriation was under consideration--brought to light a reported value of \$9,000,000 for that portion of CTN.⁴⁶

The amount of minority participation in CTN by Brazilian investors has been reported only as small.⁴⁷

V. PRIVATE BRAZILIAN-OWNED UTILITIES

Discussion of utility enterprises in Brazil would not be complete without some mention of private Brazilian enterprises. Information on private Brazilian telephone utilities is exceedingly scanty, so this discussion will concentrate on electric light and power utilities. However, the parallels between electric power and telephone utility development in Brazil are strong, especially with respect to the dominance of foreign capital as already mentioned and the regional nature of utility development in Brazil to be discussed later in this chapter.

Earlier in this chapter, it was mentioned that private Brazilian companies accounted for 23 percent of the installed electric power generating capacity and 18 percent of the total electric power production in Brazil in 1958. The nature of this supply can be seen from 1952 data. In that year, a total of 93 percent of the electric power plants in service in the country had generating capacities of less than one

⁴⁶New York Times, May 7, 1962, p. 49.

⁴⁷International Telephone and Telegraph Corporation sources in New York.

thousand kilowatts. The combined capacity of these plants represented only 13 percent of the total generating capacity in Brazil. In fact, only 2 percent of the nation's plants had individual capacities of five thousand kilowatts or greater, and these plants had a combined generating capacity of 70 percent of the total capacity in the country. In 1953, the two foreign-owned utilities accounted for 61.8 percent of the nation's generating capacity. The private Brazilian utilities clearly owned the multitude of low capacity plants, while the foreign-owned utilities owned the relatively few high capacity plants.⁴⁸ According to 1950 data, some 28 percent of Brazil's generating capacity was provided by 1,944 separate electric power enterprises, of which 90 percent had individual plant capacities of less than one thousand kilowatts. Coupled with the fact that these smaller, scattered plants, for the most part, served the interior areas of the country, while the foreign-owned utilities were concentrated in the more developed, southeastern regions, these figures show the splinter character of the total Brazilian electric light and power utility structure.⁴⁹

Research for this thesis has not disclosed any data to compare, over time, the relative roles of foreign-owned and

⁴⁸Fink, op. cit., pp. 1-4.

⁴⁹Joint Brazil-United States Economic Development Commission, The Development of Brazil (Washington: U.S. Government Printing Office, 1954), p. 160.

private Brazilian-owned utilities. However, the trend has been toward consolidation and integration of facilities, with fewer enterprises involved.⁵⁰ This is evident, for example, from the nature of foreign investment in electric light and power utilities as described above. Both Brazilian Traction, Light and Power Company (Brazilian Traction) and American & Foreign Power Company (AMFORP) purchased and consolidated numerous smaller facilities upon their entry into Brazil.

In a sense, this means that foreign-owned utilities did squeeze local nationals out of the utility business, especially in the lucrative market areas of Southeastern Brazil. On the other hand, foreign investment integrated facilities and brought in capital to develop electric power systems that were instrumental in advancing the development of that region.

VI. PUBLIC BRAZILIAN-OWNED UTILITIES

Public Brazilian-owned utility enterprises have been assuming increasing importance, not only because of the nationalization of certain existing enterprises, but also because of direct public investment in the utilities industry.

With respect to telephone utilities in Brazil, little information is available on the growth of public enterprises, primarily because, until 1962 when the Federal Government of

⁵⁰Ibid.

Brazil began consideration of a national telecommunications plan, there was little government activity in this field. According to 1962 figures, private enterprise accounted for 95 percent of the telephones in service in Brazil.⁵¹

Direct public investment in electric light and power utilities has been assuming increasing importance in recent decades. Prior to 1945, there was essentially no government investment in this field.⁵² As of 1958, however, public enterprises accounted for 14 percent of the total installed generating capacity in Brazil and 11 percent of the electric power production, as noted earlier in this chapter. Both State and Federal investments were involved in this development. The major Federal investment has been in the Companhia Hidroeletrica do Sao Francisco (CHESF) on the Sao Francisco River at the juncture of the States of Bahia, Pernambuco, Sergipe, and Alagoas.⁵³ At the end of 1955, CHESF had 180,000 kilowatts of generating capacity installed and another 180,000 kilowatts under construction.⁵⁴ At the same time, seven other public corporations owned by six states had an additional 150,000 kilowatts of installed capacity

⁵¹American Telephone and Telegraph Company, The World's Telephones, 1962 (New York: American Telephone and Telegraph Company, 1962), pp. 4-5.

⁵²David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), p. 16.

⁵³United States Department of Commerce, loc. cit.

⁵⁴Cavers and Nelson, loc. cit.

and 489,000 kilowatts of capacity under construction.⁵⁵

The motivation behind public investments such as these is typified by the situation in the State of Minas Gerais in the early 1950's. This State had an unusually attractive setting for industrial development. There were a number of sizable urban centers, an abundance of varied mineral resources, and good hydroelectric power sites. However, deficiencies in transportation and electric power were regarded as hindering development. Power supply in the State consisted of numerous, small enterprises that were not interconnected. At the end of 1952, the State had a generating capacity of 256,000 kilowatts, provided by 430 power plants, of which only 360 were in public service. It was reported that 262 of the power plants in the State had a generating capacity of less than one hundred kilowatts, and only 43 had a generating capacity in excess of one thousand kilowatts. There were 359 different owners for these various installations. Two of these owners were Companhia Forca e Luz de Minas Gerais, a subsidiary of American & Foreign Power Company providing a generating capacity of 24,724 kilowatts at that time, and Companhia Sul Mineira de Eletricidade, a private Brazilian-owned company providing a generating capacity of 21,000 kilowatts. During the decade preceeding 1952, installed capacity in the State of Minas Gerais grew at an

⁵⁵Ibid.

annual rate of less than 5 percent, while estimates indicated that demand, if it could have been met, would have grown at a rate of at least 10 to 12 percent a year.⁵⁶

Under these circumstances, the State inaugurated a power development program. The basic philosophy of the program was outlined by Governor Kubitschek, who later became President of Brazil, in a 1951 message to the Minas Gerais legislature:⁵⁷

The State has for some years past been supporting private initiative in its efforts at creating an electrical system.

Now the State is obliged to intervene in the sphere of power industries.

At the present stage of the State's development, a rapid and rational increase of the electric power industry is absolutely necessary, and the Government's duty is to stimulate private enterprise; where private enterprise should prove inadequate or nonexistent, the Government must supplement or substitute for it. . . .

.

Direct intervention of the State in such areas should be restricted to the construction and operation of large power stations and transmission lines. Power thus produced would be sold to the private or municipal distribution systems which would resell it to consumers.

As of 1958, the power company established by the State of Minas Gerais, Centrais Eletricas de Minas Gerais, had a generating capacity of 172,000 kilowatts, representing 4

⁵⁶Joint Brazil-United States Economic Development Commission, op. cit., pp. 212-15.

⁵⁷Ibid.

percent of the installed capacity in Brazil.⁵⁸

Thus, government power development programs grew in response to the needs of economic development in various regions of Brazil, regions whose development had been hindered by lack of adequate power resources. As in Minas Gerais, government projects frequently operated alongside subsidiaries of foreign holding companies and private Brazilian enterprises, supplementing their generating capacity with electric power the privately owned companies redistributed to consumers. These developments are not without significance, which will be discussed in later portions of this thesis.

VII. STATE OF ECONOMIC DEVELOPMENT IN BRAZIL

Thus far, we have discussed only the nature and extent of utility investment in Brazil, especially the investment of foreign holding companies. The true significance of this investment is not apparent unless one considers the relationship of public utilities to the Brazilian economy as a whole.

Brazil is the fifth largest nation in the world with 3.3 million square miles, and it ranks eighth in population with seventy million inhabitants.⁵⁹ According to 1958 figures, it has a per capita gross national product, expressed in United States Dollars, of \$250. This compares with \$474 in Argentina, \$931 in the Federal Republic of Germany,

⁵⁸United States Department of Commerce, op. cit., p. 110.

⁵⁹Ibid., p. 3.

\$1,113 in France, \$1,078 in the United Kingdom, and \$2,324 in the United States.⁶⁰ Although in recent decades significant strides toward industrialization have been taken, the economy of Brazil is still primarily agricultural and generally regarded as underdeveloped. According to 1960 census figures, 54.9 percent of the population lived in rural areas.⁶¹ In 1950, some 58 percent of the labor force was engaged in agriculture, and an additional 2 percent was employed in forestry and fishing. Preliminary data for 1960 revealed that agricultural production accounted for 26 percent of the national income; industry, for 27 percent.⁶² Agricultural products, especially coffee, dominate the export market. Coffee exports accounted for 60 to 70 percent of the value of all exports during the period 1950-1957, although recently the figure has fallen below 60 percent. Agricultural products contributed nearly 75 percent of the total value of Brazilian exports in 1960.⁶³

Since World War II, the fastest growing sector of the Brazilian economy has been industry, the index of industrial production rising from a base value of 100 in 1949 to 235.1

⁶⁰Yearbook of National Account Statistics 1963 (New York: United Nations, 1963), pp. 321 ff.

⁶¹Demographic Yearbook 1962 (New York: United Nations, 1962), p. 308.

⁶²United States Department of Commerce, op. cit., pp. 75 ff.

⁶³Ibid., pp. 157 ff.

in 1958.⁶⁴ A combination of factors has encouraged industrial growth. First, a high level of demand for finished goods has been unsatisfied because of recurrent exchange shortages which prevent their importation. Second, high profits in manufacturing enterprises have attracted considerable capital, domestic and foreign. Third, the government has encouraged the development of domestic manufacturing in order to conserve foreign exchange through restrictive tariff policies and open invitation to foreign investors.⁶⁵

As a result, industries have developed to a substantial degree, with widely diversified production and industrial depth. Whereas Brazil once imported most finished consumer goods, the country has now developed a large number of light manufacturing facilities and a rapidly growing producer goods industry. Consumer demands are now supplied largely by domestic manufacturing, including such products as household appliances, pharmaceutical products, office equipment, chinaware, building materials, chemicals, leather goods, rubber goods, and many other items. More basic manufactures such as automotive trucks, rolled steel, industrial chemicals, industrial equipment, electrical equipment, and other items have been specifically encouraged by the government, and some of these industries are nearly fully developed and self-sufficient.⁶⁶

⁶⁴Ibid., pp. 115 ff.

⁶⁵Fink, op. cit., p. 5.

⁶⁶United States Department of Commerce, loc. cit.

As in utilities, foreign capital has played a significant role in manufacturing sectors of the economy. As mentioned earlier, as of 1959, foreign capital had contributed 31 percent of the total public and private investment in Brazil. The United States had supplied 37.5 percent of the foreign capital, more than half of which was invested in manufacturing. Thus, United States investments in manufacturing alone represented roughly 6 percent of the total public and private investment in Brazil, and all United States investments in Brazil represented roughly 12 percent of the total.⁶⁷

One of the most significant aspects of Brazilian economic development is its geographical lopsidedness. One area of the country, the southeastern - comprising the States of Espirito Santo, Guanabara, Rio de Janeiro, Minas Gerais, Parana, and Sao Paulo - accounts for 47 percent of Brazil's population, 13 percent of the land, and 70 percent of the national income. Another area, consisting of the Amazon Valley and the frontier west, is the most sparsely populated section of the country. A third area, comprising the northeastern states, has the lowest per capita income in the nation, with widespread poverty and social unrest.⁶⁸ Table V below groups the various states of Brazil by region,

⁶⁷Ibid., pp. 11-14.

⁶⁸Ibid., pp. 59 ff.

and shows the vast disparities in terms of shares of total national income and per capita income for 1958.

From the nature of Brazil's economic development, it is clear that further advancement must proceed in two directions: sideways, bringing increased prosperity to the less developed areas; and forward, bringing increased prosperity to the developed and less developed areas alike.

VIII. REGIONAL DEVELOPMENT OF UTILITIES IN THE INFRASTRUCTURE

Many of the problems in economic development revolve around the economy's infrastructure--that is the supply of water, transportation, power, communications, and other essential services on which development depends. If development is to advance, these services must keep up with the demand for them. At this point in Brazilian development, an adequate infrastructure base is all the more important because of the growing producer goods industries which typically require large amounts of water, power, and the like. The Joint Brazil-United States Economic Development Commission stated flatly in its 1953 report to the Brazilian Government that, "The shortage of electrical energy has become one of the greatest impediments to the economic development of Brazil."⁶⁹ The reasons for the shortages are a matter considered in Chapter IV of this thesis, but the point to be

⁶⁹ Joint Brazil-United States Economic Development Commission, op. cit., p. 35.

TABLE V

PERCENTAGES OF TOTAL AREA, POPULATION, AND NATIONAL INCOME
IN BRAZIL BY STATES AND FEDERAL TERRITORIES

REGIONS BY STATES AND FEDERAL TERRITORIES	PERCENT OF TOTAL AREA	PERCENT OF TOTAL 1960 ESTIMATED POPULATION	PERCENT OF TOTAL NATIONAL INCOME 1958	APPROXIMATE PER CAPITA NATIONAL INCOME 1958, (U.S. Dollars)
North:	42	3	2	\$165
Rondonia Territory				
Acre Territory				
Amazonas				
Rio Branco Territory				
Para				
Amapa Territory				
Northeast:	11	24	9	\$100
Maranhao				
Piaui				
Ceara				
Rio Grande do Norte				
Paraiba				
Pernambuco				
Alagoas				

(continued)

TABLE V (CONTINUED)

REGIONS BY STATES AND FEDERAL TERRITORIES	PERCENT OF TOTAL AREA	PERCENT OF TOTAL 1960 ESTIMATED POPULATION	PERCENT OF TOTAL NATIONAL INCOME 1958	APPROXIMATE PER CAPITA NATIONAL INCOME 1958, (U. S. Dollars)
East: Sergipe Bahia Minas Gerais Espirito Santo Rio de Janeiro Guanabara	15	35	36	\$265
South: Sao Paulo Parana Santa Catarina Rio Grande do Sul	10	34	50	\$380
Central-West: Goias Mato Grosso	22	4	3	\$185
Brazil (Total)	100	100	100	\$255

Source: United States Department of Commerce, Brazil. (Washington: U.S. Government Printing Office, 1961), p. 61.

noted here is simply the importance of power in the infrastructure. Although the Joint Commission did not address itself to the importance of telephone communications, this aspect of utility development, too, is an integral part of modern economic development.

We have noted previously that the foreign holding companies dominated the telephone and electric light and power utilities in the Brazilian economy. For this reason alone, these companies were deeply involved in problems of economic development. According to 1962 figures, Brazil had only 1.42 telephones per one hundred persons, as opposed to the United States, which had 41.80; France, which had 10.07; Argentina, which had 6.40; the Federal Republic of Germany, which had 11.50; and the United Kingdom, which had 16.25.⁷⁰ In the production of electric power, according to 1960 figures, Brazil produced only 323 kilowatt-hours per person in its population. A comparable figure for the United States was 4,650; for France, 1,580; for Argentina, 523; for the Federal Republic of Germany, 2,180; and for the United Kingdom, 2,590.⁷¹

The infrastructure that the foreign utility holding

⁷⁰American Telephone and Telegraph Company, loc. cit.

⁷¹Figures based on production data given in the Statistical Yearbook 1962 (New York: United Nations, 1962), p. 489; and mid-year population estimates given by the Demographic Yearbook 1961 (New York: United Nations, 1961), pp. 126 ff.

companies have dominated in terms of electric light and power and telephone services has been as geographically uneven as the development of Brazil's various regions. And, the lack of adequate infrastructure in the less developed of these regions has been a principal reason for their lack of development.

With respect to telephones, little information is available on their distribution throughout the country's regions. However, The World's Telephones, 1962⁷² lists the concentration of telephones in Brazil's major cities. In 1962, Brazil was credited with 1,046,621 telephones, 95 percent of them provided by private enterprise.⁷³ Of the 16 principal cities listed with a total of 782,299 telephones or 75 percent of the national total, 15 were located in the southern or eastern portions of the country, as grouped by Table V above, accounting for 772,299 telephones or 74 percent of the national total. The remaining city was the Capital, Brasilia, in the Central-West area. The telephones accredited to those cities do not include concentrations of telephones in developed neighboring suburban and rural communities.⁷⁴ If the latter telephones were included, the concentration in the southeast would be much

⁷²American Telephone and Telegraph Company, loc. cit.

⁷³Ibid.

⁷⁴Ibid., p. 12.

greater. It is not hard to visualize the scarcity of communications in the remaining 75 percent of the country. Table VI presents the data for the cities below. The high number of telephones per one hundred persons for these cities compared to the national average of 1.42 telephones per one hundred persons confirms the suspicion that the less developed areas must be far below the national average.

The geographic disparities in infrastructure are readily apparent in the regional development of electric power as well. According to 1950 data, Brazil had an average generating capacity of 30 watts per person for the nation as a whole, and an average production of 160 kilowatt-hours per person. Yet, in the area around the City of Rio de Janeiro, served by Brazilian Traction, Light and Power Company (Brazilian Traction), there were 150 watts of generating capacity per capita and a production of 745 kilowatt-hours per capita. In the area around the City of Sao Paulo, also served by Brazilian Traction, there were 218 watts of capacity per capita and a production of 1,165 kilowatt-hours per capita. In fact, as of December 31, 1953, the two major metropolitan areas of Rio de Janeiro and Sao Paulo comprising 10 percent of the nation's population had 49 percent of the installed generating capacity in public service and consumed 56 percent of the electrical production of the country. In large parts of the country, there was no electricity.⁷⁵

⁷⁵Fink, op. cit., p. 1.

TABLE VI

TELEPHONES IN PRINCIPAL BRAZILIAN CITIES IN 1962
GROUPED BY REGION

REGIONS AND CITIES	NUMBER OF TELEPHONES	POPULATION IN THOUSANDS	TELEPHONES PER 100 PERSONS
East:			
Belo Horizonte	29,161	735	4.0
Campos	3,857	299	1.3
Niteroi	19,480	515	3.8
Petropolis	9,338	156	6.0
Rio de Janeiro	343,991	3,422	10.1
South:			
Campinas	12,847	220	5.8
Caxias	1,589	108	1.5
Curitiba	14,944	361	4.1
Londrina	3,413	135	2.5
Ponta Grossa	1,888	91	2.1
Porto Alegre	29,514	672	4.4
Rio Grande	1,421	103	1.4
Santa Maria	1,652	122	1.4
Santos	26,803	273	9.8
Sao Paulo	272,401	4,025	6.8
Central-West:			
Brasilia	10,000	200	5.0
Brazil (Total)	1,046,621	73,000	1.4

Source: American Telephone and Telegraph Company, The World's Telephones, 1962 (New York: American Telephone and Telegraph Company, 1962), p. 12.

More recent and detailed figures by state and territory reveal the disparities between regions in their electric power development more clearly. In 1961, the Northern area of Brazil consumed 43.5 kilowatt-hours per capita; the Northeast, 47.5; the East, 257; the South, 409; and, the Central-West, or Mid-West, 32.5. Table VII below presents data for generating capacity and consumption per capita by state or territory and region for 1961. Generating capacity per capita must be interpreted cautiously, because power transmission lines traverse regional and state borders so that consumption in one area is often produced in another.⁷⁶

Figures that show regional distribution of foreign investment in utilities are not available. However, as noted previously, foreign investment was primarily concentrated in Southeastern Brazil, the most developed area of the country, while Brazilian investment was primarily concentrated in the other, less developed areas. In other words, the regional distribution of foreign and Brazilian investment has not been the same. Foreign investment was not only dominant in the entire utility structure of Brazil, but it was even more dominant in the best market area of the country.

IX. PROBLEMS OF ELECTRIC LIGHT AND POWER UTILITY DEVELOPMENT

The electric power industry in Brazil faces peculiar

⁷⁶Fundacao Getulia Vargas, Instituto Brasileiro de Economia, Conjuntura Economica, International Edition, Rio de Janeiro, Year XI, No. 1 (January, 1964), p. 70.

TABLE VII

PER CAPITA PRODUCTION AND CONSUMPTION OF ELECTRICAL ENERGY IN BRAZIL BY
STATE OR TERRITORY AND REGION IN 1961

REGION AND STATE OR TERRITORY	POPULATION (MILLIONS OF INHABITANTS)	GENERATING CAPACITY PER CAPITA - WATTS	CONSUMPTION PER CAPITA KILOWATT-HOURS
North:	2.7	21.5	43.5
Rondonia	0.08	30	91
Acre	0.17	16	23.5
Amazonas	0.75	8	22
Roraima	0.03	13	20
Para	1.6	25	47
Amapa	0.07	100	194
Northeast:	16.0	8	47.5
Maranhao	2.6	3	7
Piauí	1.3	4.5	12
Ceara	3.4	8.5	22
Rio Grande do Norte	1.150	7	20
Paraíba	2.049	7	67
Pernambuco	4.2	12	103
Alagoas	1.3	9	45.5
Fernando Noronha	0.001	300	900

(continued)

TABLE VII (CONTINUED)

REGION AND STATE OR TERRITORY	POPULATION (MILLIONS OF INHABITANTS)	GENERATING CAPACITY PER CAPITA - WATTS	CONSUMPTION PER CAPITA KILOWATT-HOURS
East:	25.5	824	257
Sergipe	0.8	1.75	26
Bahia	6.1	59	45.5
Minas Gerais	10.2	79	228
Espirito Santo	1.4	27	56
Rio de Janeiro	3.6	239	402
Guanabara	3.4	12.5	723
South:	25.7	94.5	409
Sao Paulo	13.4	145	655
Parana	4.5	35	144
Santa Caterina	2.2	43	142
Rio Grande do Sul	5.6	42	134
Mid-West:	3.2	12	32.5
Mato Grosso	1.0	19	16
Goias	2.0	7	38
Brasilia, Federal District	0.2	31.5	60
Brazil (Total)	73.1	65	247

Source: Fundacao Getulio Vargas, Instituto Brasileiro de Economia, Conjuntura Economica, International Edition, Rio de Janeiro, Year XI, No. 1 (January, 1964), p. 70.

problems in connection with development. Although Brazil is believed to have oil and coal resources, these have not been developed. Because of the scarcity of fuel, the high cost of importing it, the attendant drain on foreign exchange, and Brazil's wealth in hydro sources, hydroelectric sources of power have been developed much more extensively than thermal ones. At the end of 1953, 79.6 percent of the total generating capacity of the country in public service was based on hydro sources.⁷⁷

Capital expenditures for hydroelectric power development have been considerably greater than those for thermal development. In 1954, eight hydroelectric projects had a cost range of \$252 to \$508 per kilowatt of generating capacity, while a thermal project cost only \$194 per kilowatt.⁷⁸

Development of hydroelectric power sources, then, requires a large capital outlay per kilowatt of generating capacity, an outlay considerably greater than that required for thermal electric power development. This means that public or private investors in hydroelectric power development must have access to considerable financial resources. For example, in June of 1964, President Humberto Castelo Branco of Brazil approved a plan recommended by the International Bank for Reconstruction and Development for power

⁷⁷Fink, op. cit., p. 3.

⁷⁸Cavers and Nelson, op. cit., p. 87.

development in Brazil. Noting that the annual growth rate for power consumption had been between 8 and 12 percent per year in Brazil's industrial areas, the plan proposed the construction of five new hydroelectric facilities and the expansion of two others in order to raise installed generating capacity by 1,792,000 kilowatts. The report observed that any substantial delay in the execution of these projects or the completion of existing ones would have "very grave consequences for the national economy". The price tag on the proposed projects was two billion dollars.⁷⁹ This figure is greater than the book value of foreign investment in Brazilian electric light and power utilities today.

X. IMPLICATIONS FOR FOREIGN-OWNED UTILITIES

In bringing this chapter to a close, it is appropriate to focus on the implications of the material presented.

First, the foreign-owned utilities dominated the electric light and power and telephone services in the infrastructure of the Brazilian economy. Even though foreign investment supplied much needed developmental capital, there was considerable risk inherent in this type of investment. Under any circumstances and in any country, an investment by foreigners in public utilities of this size and with this much control has risk. Utilities are a particularly sensitive area of foreign investment. Telephones are vital to a

⁷⁹New York Times, June 20, 1964, p. 29.

nation's communication system, and electricity is a prerequisite to industrial growth. It is not unusual for a host country to regard these utilities as vital to the national security and national development, and, hence, subject to government control, sometimes to the point of excluding foreign interests. In addition, by the nature of the services that are essential to modern life, telephone and electric utilities are highly visible to the population of a nation. When these utilities fail to meet popular expectations, popular opinion is quick to react, with ensuing political implications.

Second, in the case of foreign-owned utilities in Brazil, this type of risk has been compounded by the state of economic development. Although the Brazilian economy is still primarily agricultural, in recent decades the country has made significant strides toward industrialization. This industrial development placed an extra burden on public utilities in Brazil, particularly the electric power industry. This burden not only made it imperative for the utilities to expand their services, but it also made them especially vulnerable to governmental policies designed to generate further industrial development.

Third, in addition to the state of economic development in Brazil, the manner in which that development has proceeded has had a bearing on the risks faced by the foreign utility

operators. Essentially, Brazilian economic development has been geographically lopsided, the southeastern portion of the country being, by far, the most developed. Public utility development has been equally lopsided. The regional inequalities have been a great source of concern in Brazil, and increased the vulnerability of foreign-owned utilities to government policy. For one, Brazilian efforts to industrialize the underdeveloped portions of the country have had to include, explicitly or implicitly, plans for the employment of foreign capital in utility development. This Chapter noted the rapid growth of public investment in utilities in these areas after the Second World War, implying a choice between public and private investment that was made in favor of public investment. For another, one can infer that the less developed portions of Brazil have probably not been a source of political support for the foreign-owned utilities, since these utilities did not appreciably invest in those regions.

Fourth, the regional distribution of foreign and private Brazilian investment in utilities may have had an effect on the risks faced by the foreign utility operators. The foreign-owned utilities occupied the best market areas of Brazil, and contributed to their development, by buying out many private Brazilian operators and consolidating facilities. In effect, private Brazilian operators were squeezed out of those areas, which may have created lingering resentment against foreign capital.

Finally, the nature of utility investment in electric power facilities has had implications for foreign investors. By relying extensively on hydroelectric sources of power, Brazil has needed and will continue to need large amounts of capital for development. Foreign investment in electric light and power utilities, therefore, has been a substantial portion of the total investment in Brazil, increasing the visibility of the foreign enterprises. In addition, the large capital outlays required for expansion could only have made the problems of financing more difficult for foreign investors. Furthermore, the large capital outlays required for electric power development implicitly posed to the Brazilian Government the question of the desirability of so much foreign capital in the infrastructure.

CHAPTER III

REGULATION OF ELECTRIC LIGHT AND POWER AND TELEPHONE UTILITIES IN BRAZIL

The historical origin of the underlying problems of the foreign utilities in Brazil, as well as those of the multitude of smaller domestic operators, lies in the regulatory structure under which the utilities operated. This chapter discusses those portions of Brazilian regulatory law applicable to the operations of electric light and power and telephone utilities.

I. THEORY OF UTILITY REGULATION

Before describing the laws themselves, it is useful to introduce the fundamental concepts of utility regulation used in the Western Hemisphere, including the United States, so that the Brazilian laws can be viewed in the proper perspective.¹ The general principle is that utilities enjoy a natural monopoly position--being a decreasing cost activity over a wide range of increasing production--and should not, therefore, be allowed complete freedom in the determination of prices charged for services. The rate-making process,

¹The following discussion on the theory of utility regulation has been abstracted from David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), pp. 110 ff.

however established, determines prices that: one, allow recovery of genuine operating costs such as labor and fuel; two, allow recovery of appropriate depreciation allowances so that retired equipment can be replaced with new plant; and three, allow sufficient return on bona fide invested capital so that new expansion can be financed out of earnings or new issues of securities or both. The evolution of acceptable accounting techniques has removed most of the difficulties in determining costs and depreciation on the basis of experience. Determining what constitutes an adequate return presents problems. The rate of return must be high enough so that additional capital can be attracted to the enterprise when needed. This means that present equity holders must earn on their investment a rate of return comparable to that realized from alternative investments. An "adequate" rate of return, therefore, is determined in the capital markets servicing the utility. Whether or not this is the return legally permitted is another question-- and a common center of controversy.

Rate problems are compounded when there is debt in the capital structure, because debt creates leverage for equity holders. When there is leverage, the return to shareholders is different than the return to the total invested capital. A simple example illustrates the meaning of leverage. If the consolidated capital structure of a utility amounts to \$100, of which \$50 is debt requiring a 5 percent annual rate

of interest and \$50 is equity, and the legally fixed rate of return on total investment is 10 percent, then the annual return to total capital is \$10. However, interest payments out of that return amount to \$2.50, leaving \$7.50 for the equity holders, which amounts to a 15 percent rate of return on their investment. In this instance, leverage has made the equity holders' rate of return greater than the legally fixed rate of return to total investment. If the legally fixed rate of return to total investment is subsequently reduced by 25 percent to 7.5 percent, the value of the total return will fall to \$7.50, leaving equity holders \$5.00 after deductions of interest payments, or a 10 percent rate of return on their investment. In this case, the rate of return to equity fell by 33 percent, which is greater than the reduction of the total rate of return. Thus, the effect of leverage is to amplify variations in the rate of return to equity resulting from variations in the rate of return to total invested capital. Some regulatory systems make allowance for leverage, and assign different legal rates of return to the components of the capital structure; others, like the Brazilian regulatory system, ignore leverage, assigning a single legal rate of return to the total investment.

The usual method for determining return on investment is to fix a rate base and apply a rate of return to that base. The rate base usually reflects either historical

value of the investments less depreciation or present value of the assets. Utility prices are adjusted so that return on investment is provided according to the chosen formula. Both the rate base and the rate of return are prescribed by the regulatory systems.

The United States uses a system of regulatory commissions, semi-independent of executive branches of government and subject to judicial review, to determine rate base and rate of return. Controversy continues as to whether the rate base should reflect historical investment or present value. When the cost of replacing or expanding physical plant is stable over time, present value and historical value are not critically different. When, however, these costs rise over time, then historical values underestimate real value, and the real value of the return to equity holders falls, assuming that the applied rate of return is constant.

As will be seen, Brazilian methods are more rigid than those in the United States, in that the rate base and rate of return are prescribed by law, and changes in utility rates necessitated by changing operating costs are determined by politically-appointed agencies of the executive branch of the government.

Since electric power and telephone regulation in Brazil are somewhat different, each will be considered separately. Throughout the discussion of the regulatory systems for

electric light and power and telephone utilities, it should be kept in mind that the laws applied equally to foreign and domestic investors.

II. BRAZILIAN REGULATION OF ELECTRIC LIGHT AND POWER UTILITIES

Prior to 1934, there was no centralized machinery in Brazil for granting and regulating public utility concessions, contracts for power companies being negotiated individually with local authorities. Such contracts stipulated the operating conditions, the duration of the concession, the disposition of the assets upon expiration of the concession and the amount of compensation to be paid for assets reverting to the granting authority, and the rates to be charged. Changes in rates were negotiated by the concessionaire and the granting authority. Although these contracts were not based on a clearly defined legal doctrine concerning exclusive exploitation, in practice they granted monopolies in their concession areas. The insertion of a "gold clause" became widespread in the case of foreign investors. The effect of such a clause was to allow rate adjustments linked to variations in the foreign exchange rate.² In November, 1933, the federal government ruled that all contracts containing such clauses were null and void, thereby abolishing

²Joint Brazil-United States Economic Development Commission, The Development of Brazil (Washington: U.S. Government Printing Office, 1954), pp. 168-69.

automatic adjustments of tariffs according to the exchange rate.³

Partly due to economic and political changes resulting from the depression, Brazilian thinking about the old arrangements changed,⁴ and in 1934 a new Constitution was put into effect. The new Constitution stated that waterfalls in public rivers were national property, and that Federal concessions were required for hydroelectric development, such concessions being granted only to Brazilians or companies organized in Brazil. Article 137 provided that the Federal Government should establish a law regulating the rates of hydroelectric companies so that those companies could earn only a fair return on their capital. Fair return was defined as a return that would take care of normal requirements and necessary expansion and improvement. In the Transitory Provisions, Article 12 stated that private persons who operated hydroelectric facilities were to be subject to federal law to be promulgated, and that concession contracts in existence were to be subject to revision.⁵ The new Constitution also assured the Government the right to take over

³Moody's Public Utility Manual 1950 (New York: Moody's Investor Service, Incorporated, 1950), p. 1120.

⁴Joint Brazil-United States Economic Development Commission, loc. cit.

⁵Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960), pp. 41-44.

the assets of a concession after the period established in the original contract had expired. Adequate indemnity for properties reverting to the Government was called for in this concession limitation.⁶ In effect, the 1934 Constitution established a policy whereby hydroelectric companies were to be regulated by the Federal Government through an administrative commission to be established by appropriate legislation.⁷

To implement the provisions of the 1934 Constitution, the Code of Waters was enacted in the same year.⁸ The Code envisioned comprehensive regulation of hydroelectric power companies, and in Article 178, regulatory responsibility was entrusted to a Division of Waters in the National Department of Mineral Production of the Ministry of Agriculture. The Code made provision for the centralized granting of concessions, the supervision of issues of securities and of methods of accounting, the establishment and revision of power rates, and the setting of time limits on concessions.⁹ Objectives of regulation as set forth in the Code were the assurance of adequate service, the guarantee of the financial stability of the enterprise, and the fixation of reasonable rates. Regulation was to be based on historical costs, and

⁶Joint Brazil-United States Economic Development Commission, loc. cit.

⁷Fink, loc. cit.

⁸Decree 24,643, July 10, 1934.

⁹Joint Brazil-United States Economic Development Commission, loc. cit.

Article 180 of the Code provided that rates should be fixed every three years so that reasonable rates would recover costs of services--including operating expenses, taxes of all kinds except improvement assessments, depreciation charges, and return on the capital of the enterprise. No changes could be made in rates until new concession contracts had been entered into in accordance with the provisions of the Code.¹⁰

The elaborate regulations established in the Code of Waters were never really put into effect through the issuance of appropriate regulatory decrees. By preventing the companies from complying with certain provisions of the Code, this lack of regulatory decrees unnecessarily imposed restrictions on the operations of the companies. For example, no rate changes could be made because no new concession contracts could be entered into, and no expansion of property could be undertaken because provisions of the Code could not be complied with.¹¹

In 1937, a new constitution was enacted. In general, provisions relating to hydroelectric power utilities remained unchanged, except for one added provision--the requirement that holders of the voting stock in hydroelectric corporations must be Brazilian. This new provision was put into effect through Decree Law 852 of November 11, 1938.¹²

¹⁰ Fink, loc. cit.

¹¹ Ibid.

¹² Ibid.

On May 18, 1939, a National Council of Waters and Electric Energy, originally called for in the Code of Waters to study and rule upon the granting of the new contract concessions and upon the expansion of existing power facilities, was finally created. The Council was to act as a board of appeals in disputes between concessionaires and the Government, and possessed very extensive powers relating to developmental planning of electric power, legislation, interconnection of service, and other related items. The effect of the Council's creation was to modify previous restrictions on plant expansion that had resulted from failure to implement the provisions of the Code of Waters. Investment could proceed anew, but not until the end of the Second World War, when shortages of equipment ceased.¹³

The Code of Waters was partially implemented and modified by Decree Law No. 3,128 of March 5, 1941. This law defined historical cost as the amount actually invested in the productive properties of the concession and provided that such historical cost was to serve as the basis for fixing rates and determining compensation to be paid the concessionaire in event assets reverted to the Government. The law authorized The Division of Waters of the Ministry of Agriculture (established by the Code of Waters) and the National Council of Waters and Electric Energy (created in

¹³Joint Brazil-United States Economic Development Commission, op. cit., pp. 155-57 and 169.

1939) to inventory the properties of concessionaires and determine the original costs of such properties according to vouchers and records of the companies. The law provided that if the determinations of original cost of a concession proved to be unsatisfactory due to inaccuracies in, or unreliability of, company records, then a board of experts was to determine proper historical cost. Under provisions of this same law, profit to be allowed on a concessionaire's investment was to be limited to 10 percent per year of the historical cost less depreciation, unless significant changes occurred in the internal securities or monetary markets, in which case the return could be changed to an amount no greater than the yield on internal government bonds plus 3 percent.¹⁴

Neither the Division of Waters nor the National Council of Waters and Electric Energy were adequately staffed to carry out the evaluations required by the 1941 law. Authorities consequently tended to delay making decisions on the granting of new concession contracts or the confirmation of old ones, and rate adjustments and expansion plans were further delayed.¹⁵

Due to increasing power shortages arising from delays in the implementation of the Code of Waters and the

¹⁴Fink, loc. cit.

¹⁵Joint Brazil-United States Economic Development Commission, op. cit., p. 170.

restrictions on expansion of capacity resulting from World War II equipment shortages, the Federal Government, in Decree Law No. 4,295 of May 13, 1942, empowered the National Council of Water and Energy to establish rules for the rationing of a concessionaire's electric energy.¹⁶

On August 19, 1943, the Code of Waters was further modified and the restrictions somewhat relaxed through the issuance of Decree Law No. 5,764. This law provided that electric energy companies should continue to be regulated by their existing concession contracts, pending the execution of new ones as referred to in Article 202 of the Code of Waters, but that regulatory jurisdiction conferred in such contracts was transferred to the Federal Government from the states or municipalities originally party to the contracts. Exception was made for public lighting contracts and similar local services. However, the Law subjected the existing contracts so transferred to the Federal Government to limitations as to: one, the area served, which might be modified according to the public interest; two, contract duration, which was to be established in the new contracts; three, future operating conditions, including rates; and, four, the supervision of concessionaire performance, which was to be governed according to provisions of the Code of Waters and subsequent legislation. These limitations were not to

¹⁶Fink, op. cit., p. 83.

affect either the integrity of the concessionaire's invested capital or his return from it. Finally, Article 5 of the 1943 Law allowed for readjustment of rates. Companies covered by the Decree Law could have provisional modifications made in their rates by submitting to the Minister of Agriculture a petition containing sufficient justification for the changes. The Government reserved to itself the exclusive right to judge the merits of petitions.¹⁷

In 1946, another new constitution was enacted, the one now in effect. Repeating essentially the regulatory provisions of the previous constitutions, the 1946 Constitution called for the passage of a new public utility law to replace the implemented fragments of the Code of Waters. The Constitution declared (Article 151) that concessionaires could not receive more than a fair return on their capital, but that the return must be adequate enough to allow improvements and expansion. In the event assets of a concession reverted to the Government, it was again declared that the concessionaire must be indemnified. The provisions in the 1937 Constitution to the effect that holders of voting stock in hydroelectric enterprises must be Brazilian was repealed.

Since no action was ever taken to implement the provisions of the 1946 Constitution with respect to electric utility regulation, previous legislation implementing the Code

¹⁷Fink, op. cit., pp. 41-44; and Joint Brazil-United States Economic Development Commission, op. cit., pp. 168-170.

of Waters has, in fact, remained in effect.¹⁸ Thus, the 1943 Law as applicable to electric power rate changes has remained in effect, and, since 1943, rate increases have been granted by the government only to meet specific changes in operating costs. Such changes were usually authorized by law, granting the electric power industry percentage increases in rates to offset appropriate increases in expenses. For example, Decree Law No. 7,524 of May 5, 1945, provided that Brazilian Traction, Light and Power companies should have a flat 10 percent increase in rates to cover an increase in wages approved by the government at the same time. This law allowed that the granting authority could make the rate increases applicable to other power companies at its discretion. Decree Law 7,716 of July 6, 1945, implemented Decree Law 7,524, and made the Division of Waters and the National Council of Waters and Electric Energy responsible for carrying out the provisions of Decree Law 7,524 with respect to electric power companies. Rate changes were put into effect through the issuance of decrees, or portaria, by the regulatory agencies.¹⁹

At this juncture, it is worthwhile to recall that the regulatory framework up to this time confined itself to hydroelectric power companies. However, some concessionaires,

¹⁸Ibid.

¹⁹Fink, loc. cit.

although predominantly hydroelectric, had thermal plants as well, and electric power supplied to consumers was indistinguishable as to its origin. In such cases, it was natural for the regulatory authorities to assume rate-making responsibility for the concession as a whole. For thermal plants, fuel--usually imported--was not an insignificant portion of operating expenses, and in 1939, clauses allowing for adjustment of rates to power (industrial) consumers for changes in fuel costs were permitted in the concession contracts. Fuel clause surcharges on rates were later extended to all consumers (power and light) by regulatory decree (Portaria No. 639 of August 12, 1948). Fuel clauses, once granted to a concessionaire, were automatic in their adjustment, unless revised by regulatory decree.²⁰

On June 5, 1950, Decree Law No. 2,281 subjected thermal electric plants to the same regulation applicable to hydroelectric plants, bringing all electric light and power concessions under Federal control. The same law also provided that electric power companies were to be exempt from all taxes, except taxes related to non-electric operations of the concessionaires and consumption and income taxes. Instead, taxes were imposed upon the basis of installed generating capacity.²¹

²⁰Fink, op. cit., pp. 42 & 79-81.

²¹Ibid., p. 44.

Also in 1950, standard accounting procedures originally called for in the Code of Waters were finally worked out and implemented.²²

Law 1,474 of November, 1951, permitted companies in Brazil to revalue their fixed assets upward according to indices fixed by the Law to account for inflationary trends. Upon doing so, companies had to pay a one-time, 10 percent tax (later 15 percent) on the amount of revaluation. Public utilities were not permitted to take advantage of this revaluation procedure.²³ There is no evidence of the Government's reasoning on this point, but revaluation of utility assets would have implied a new and higher rate base on which to calculate prices for utility services. As will be seen in Chapter V, because of popular opposition, political leaders in Brazil were reluctant to grant rate increases not immediately required to cover increases in operating expenses.

Up to 1954, companies desiring rate increases to offset government-granted wage increases would petition the Government for the rate changes. The Division of Waters reviewed the petitions and authorized rate increases in specific amounts to cover the increased labor costs, but only providing that the return earned was less than the 10 percent allowed by previous legislation. On May 1, 1954, a new minimum wage law, Law 35,450, was put into effect throughout

²²Joint Brazil-United States Economic Development Commission, op. cit., p. 170.

²³Fink, op. cit., p. 47; and Cavers and Nelson, op. cit., p. 30.

the country. The companies petitioned for rate increases, and the Minister of Agriculture authorized (Portaria No. 1,691 of November 19, 1954, of the Minister of State of the Business of Agriculture) the companies to pass on the additional expenses themselves to the consumers, with the proviso that the companies report the results of their rate increases to the Division of Waters after a ninety day experimental period. This new technique for adjusting rates was a step toward automatic rate adjustment with changing wage laws.²⁴

Through the issuance of Law No. 2,308 of August 3, 1954, Brazil established a Federal Electrification Fund to assist the financing of production, transmission, and distribution electric power facilities and the development of related electrical manufacturing industries. Financing of the Fund was achieved by levying a tax on electric light and power consumption as authorized by the Constitution (Article 15, Paragraph III).²⁵

In 1956, the administration in Brazil introduced a bill in the Congress that would, among other things, call for the revaluation of utility assets for the purposes of rate-making and otherwise create a more favorable climate for public utility operations. Pending Congressional action on the measure, an interim executive decree established new

²⁴Fink, op. cit., p. 43.

²⁵United States Department of Commerce, Brazil (Washington: U.S. Government Printing Office, 1961), pp. 109 & 181.

regulations for the Code of Waters. Decree No. 41,019 of February 26, 1957, made provisions for a system to adjust rates automatically as operating expenses changed. Such adjustments were to be made for changes in the cost of power purchased from outside the concessionaire's system, changes in the cost of fuel where applicable, government-granted changes in wages and social welfare benefits, and changes in the cost of servicing or repaying in foreign currencies registered foreign debt resulting from changes in the applicable exchange rate. Rate changes necessitated by changes in the cost of fuel, purchased power, and labor were to be made by the companies in their monthly billings, and rate changes necessitated by variations in the foreign exchange rate were to be made by the companies semi-annually. Every six months during which rate changes were in effect, retrospective studies were required by the Decree, and the regulatory authority had the power to cancel any rate changes and require the refund of any excess charges to the consumers. In any case, the Decree called for mandatory rate adjustments for the public utilities every three years.²⁶

On November 28, 1958, Law No. 3,470 was passed allowing another revaluation of corporate assets according to official indices that compensated for previous inflation.

²⁶Cavers and Nelson, op. cit., pp. 125 & 126; and United States Department of Commerce, op. cit., p. 109.

A tax of 10 percent to be paid within one year was imposed on the amount of revaluation of corporate equity securities. As passed by Congress, the measure had a provision that forbade utilities to use revalued assets in computing their return, and, hence, rates. President Kubitschek vetoed this provision, and his veto was upheld. However, no subsequent executive decrees were issued to prescribe the revaluation procedure for utilities, and consequently, utilities have not yet been able to take advantage of this Law.²⁷ The revaluation contemplated by the Law was to have been biennial.²⁸

In the previous legislation discussed, it will be noted that the Division of Waters of the National Department of Mineral Production of the Ministry of Agriculture and the National Council of Waters and Electric Energy were frequently designated--one, the other, or both--as the regulatory bodies in matters of concessions and rates. This has created considerable doubt as to the respective areas of jurisdiction of the two agencies.²⁹

In 1961, the Government issued several regulations which, in addition to other things, cancelled automatic rate adjustments for changes in the cost of foreign exchange

²⁷Cavers and Nelson, op. cit., p. 117.

²⁸American & Foreign Power Company sources in New York.

²⁹Fink, op. cit., p. 44.

needed to service foreign debts, and made such surcharges on rates subject to prior approval by the Minister of Mines and Energy.³⁰ This move was at least partially motivated by a foreign exchange crisis in Brazil, and was coupled with other efforts to conserve exchange. A later part of this chapter will touch upon exchange regulations applicable to foreign-owned public utilities.

To conclude this presentation of electric power utility regulation in Brazil, it would be useful to summarize the rather confusing and sometimes contradictory legislation to bring forward certain essential points. The 1934 Code of Waters envisioned a broad regulatory framework for electric power companies, bringing concessions formerly under local control into the realm of federal concern. However, many provisions of the Code were never fully implemented. Those provisions that were implemented were done so after considerable delay. Thus, what actually developed was a fragmentary and sometimes restrictive set of laws. The new concession contracts called for in the 1934 Code were never systematically executed, and it was not until 1943 that the government recognized the validity of the existing concessions. During this period, rates were effectively frozen,

³⁰American & Foreign Power Company Incorporated, Thirty-Seventh Annual Report, 1960 (New York: American & Foreign Power Company Incorporated, 1961), p. 13; and American & Foreign Power Company Incorporated, Thirty-Eighth Annual Report, 1961 (New York: American & Foreign Power Company Incorporated, 1962), p. 14.

because the 1934 Code forbade rate changes until concessions had been entered into with the federal government. The provisions called for in the Code relating to historical rate base and an adequate return on the concessionaire's capital were not defined until 1941. The 1941 Law defined the rate base as historical cost of assets less depreciation and the rate of return as 10 percent of that base per year. However, inflation had so devalued the rate base so that the concessionaires were actually earning very little in real terms by 1958. A law enacted in that year called for the revaluation of utility assets for the purposes of rate-making, but no administrative procedure has yet been instituted to carry out that law, with the result that electric power utilities still earn an inadequate return. After passage of the 1943 law, rate changes could proceed anew but only to cover changes in operating costs, not devaluation of the real value of return to investment. Until 1957, rate changes could not be made without prior approval of the regulatory authorities, which meant delay in obtaining changes because of administrative staff inadequacies. In 1957, rate changes necessitated by increases in operating costs became partially automatic. This helped to assure the electric utilities adequate income to cover current expenses, including depreciation of the historical value of assets, but it did nothing to provide adequate profits. The lack of adequate profits, as will be seen in subsequent chapters, explains much of the problems in the Brazilian electric power industry.

III. BRAZILIAN REGULATION OF TELEPHONE UTILITIES

A discussion of telephone utility regulation in Brazil must necessarily be more limited in scope than the foregoing discussion on electric power regulation for several reasons. First, the Federal Government of Brazil has not been as active in telephone utility regulation, by and large leaving regulation to states and municipalities which practice similar, but not identical, methods of regulation. Consequently, an exhaustive discussion would be unnecessarily complex for the purposes of this thesis. Second, little information on this subject has been translated into English, primarily because telephone communications problems have attracted less study than electric power problems in Brazil. The loss of detail, however, is not crucial, because, as will become apparent, the basic regulatory framework for telephone utilities is the same as for electric power, and the resulting problems are virtually identical--namely, little or no profit on invested capital.

As in the case of the electric power utilities, prior to the enactment of the 1934 Constitution, telephone utilities were regulated through a system of numerous state and municipal concessions. As mentioned previously, such concession contracts--regulated by local law--stipulated operating conditions, duration of the concession, the disposition of the assets upon termination of the concession, and

the rates to be charged. Rate changes were either subject to negotiation or made independently by the concessionaire. Thus, for example, in the State of Rio Grande do Sul, where telephone properties of International Telephone and Telegraph Corporation were expropriated in 1962, State Law No. 19 of January 12, 1897, provided that intermunicipal telephone services, or "communications by electricity" as the Law expressed it, were to be regulated through concessions granted by the State, while intramunicipal services were to be exclusively regulated through concessions granted by the municipalities.

First in 1934, and then again in 1937 and 1946, constitutions of those years reserved to the Federal Government the prerogative to regulate telephone utility concessions, especially with respect to the revision of tariffs. Profits of concessionaires were not to exceed fair retribution to capital, such return being sufficient to allow necessary expansion and improvements in services. As in the case of hydroelectric concessions, telephone concessions reverting to Federal or State Governments required indemnification.

Such constitutional provisions were implemented partially through the issuance of Federal Decree Law No. 5,144 of December 29, 1942, defining the rate-making process envisioned by the 1934 Constitution. Under this Law, rates were limited to those which would provide a return to capital

no greater than 12 percent per year of the "recognized capital", meaning historical cost less depreciation, and all changes in rates were subjected to prior governmental authorization. Article 8 of the Law provided that, "The non-submission of the operator, concessionaire, permissionaire, or contractor of telephone services, with a contract in force or expired, or without a contract, to the tariffs maintained in the form of the preceding article; or his refusal to render or continue the services, or his abandoning same, will oblige him, besides the legal and regulatory measures and penalties, on the conceding power's judgment to: (a), civil indemnity of the damage; (b), cancellation of all fiscal and administrative favours; and (c), taxation for the occupation of the public streets that the Public Power may decree." In effect, Law No. 5,144 subjected concessionaires to regulation without the option of their withdrawing from the regulated activity should they find their interests adversely affected.

The effect of the constitutional provisions was to give the Federal Government the power to regulate telephone utility concessions. In the case of interstate telephone services, the Government exercised this prerogative because no other power was in a position to do so. For the most part, until recently, it did not exercise its authority with respect to intrastate telephone communications, and, under the

Federal Constitution, if the Federal Government did not exercise its prerogatives, then the State Governments could have authority. However, Law 5,144 applied to all concessions regardless of the unit of government granting the concession. Thus, referring again to the State of Rio Grande do Sul, that State in 1950 took over the administration of Federal Law 5,144 with respect to rate regulation throughout the State's jurisdiction. Later, by State Law No. 2,056 of March 19, 1953, the State Government of Rio Grande do Sul reserved to itself the exclusive right to grant telephone concessions within the State, whereas previously municipalities could grant concessions for services within the municipality. It was under the same constitutional authority that Rio Grande do Sul expropriated International Telephone and Telegraph Corporation property in 1962.

Thus, in this brief exposition on telephone utility regulation, it can be seen that the rate-making process--a 12 percent rate of return applied to a historical rate base--is similar to the process used in regulation of electric power utilities. The administration of the regulation has been different, however, in that the Federal Government has confined its regulatory activities primarily to interstate service and ceded its administrative authority on other telephone services to the States which might, in turn, yield parts of their authority to municipalities. A single

concessionaire might, consequently, have concessions with more than one unit of government, as was the case of International Telephone and Telegraph Corporation's Companhia Telefonica Nacional in Rio Grande do Sul, which operated under fifty-two municipal, six State, and two Federal concessions.

Under the provisions of the 1942 Law, rate increases required prior governmental approval. This often meant that increases were confined to amounts needed to cover increases in operating costs, especially government-granted wage increases. Devaluation of the real value of the concessionaire's return through inflation was not compensated for in the regulatory system, and, as in the case of the electric power utilities, the 1958 Law providing for the revaluation of assets for the purposes of rate-making has not yet been administratively applied to telephone utilities. As will be seen in the next chapter, the devaluation of the concessionaire's return to his capital resulted in inadequate profits and concomitant deterioration in services.³¹

IV. A COMPLICATING FACTOR--FOREIGN EXCHANGE REGULATIONS

Complicating the regulatory problems of electric power

³¹Information for the discussion of telephone regulation was obtained from International Telephone and Telegraph Corporation, Untitled reply of February 26, 1962, to Court Order of February 16, 1962, confirming Rio Grande do Sul Decree No. 13,186 that expropriated International Telephone and Telegraph Corporation's property in that State.

and telephone utilities in Brazil were the import and foreign exchange controls in effect at various times. For foreign-owned utilities, exchange controls on capital transfers have been especially important. However, exchange and import controls have had significance for both foreign and domestic utilities. In 1954, 40 to 60 percent of the equipment requirements for Brazilian electric power utilities had to be purchased abroad, and, in any event, utilities--regardless of ownership--were affected by controls to the degree that they had incurred foreign obligations.³² Consequently, a discussion of utility regulation and its effects on profits must necessarily include foreign exchange and import controls.

In the immediate years following the Second World War, Brazil had a surplus of foreign exchange reserves, because the War had created a heavy demand for exports and had limited the availability of imports. In the postwar years, the prewar exchange rate--a single, fixed, official rate--was maintained for all transactions as were the prewar import duties, which assigned specific duties to various goods. Inflation during the War made the exchange rate unrealistically low, thereby undervaluing foreign exchange and lessening the protective effects of specific import duties. Consequently, the immediate postwar period, with readily

³²Fink, op. cit., p. 48.

available foreign exchange for imports and capital transactions, saw a sharp increase in imports that soon exhausted the exchange reserves. By the middle of 1947, an exchange crisis occurred, and crises have continued to recur almost every year since, with the exception of a few good years for coffee exports.³³

The official exchange rate, pegged at 18.5 cruzieros per dollar, remained unchanged until 1953, and, grossly undervaluing foreign exchange, discouraged exports and stimulated massive demand for imports. Inflation continued to undermine the protective effects of specific duties. During the period from 1947 to 1953, demand for imports was controlled through a system of licensing that established a scale of priorities for various imported goods. Generally, goods required for expansion of infrastructure received priority. For those importers who received licenses, large windfall profits occurred, leading to charges of bribery and corruption in the system. Delays and irregularities were frequent.³⁴ To help ease the foreign exchange problems, restrictions were placed on the transfer of earnings abroad and the repatriation of capital. Decree Law No. 9,025 of

³³Lincoln Gordon and Engelbert L. Grommers, United States Manufacturing Investment in Brazil (Boston: Division of Research, Graduate School of Business Administration, Harvard University; 1962), pp. 14 ff.

³⁴Ibid.

February 27, 1946, required the registration of foreign capital for repatriation or transfer of earnings that might be remitted annually. Remittances were made at the sole foreign exchange rate effective at the time, the official rate.³⁵ For most of the period from 1947 to 1953, annual repatriation of capital was limited to 20 percent, and annual transfer of earnings to 8 percent of the registered capital.³⁶ These restrictions were not especially effective in easing the exchange crises, because the investment climate encouraged foreign firms to retain much of their earnings anyway.³⁷

In early 1953, the system was radically altered through a series of new laws. Law No. 1,807 of January 7, 1953, promulgated through Decree No. 32,285 of February 19, 1953, created a free exchange market operating alongside the official rate. The Law provided that certain transfers in the exchange market, including transfers of profits of electric power companies, would be made at the official rate, while others, mostly imports of less essential items, were to be made at a "free" rate. Later, Instruction 70 of the Minister of Finance of October 9, 1953, supplemented by Law No. 2,145 of December 29, 1953, and Decree No. 34,893 of January 5, 1954, established an auction system for foreign exchange

³⁵United States Department of Commerce, op. cit. p. 151.

³⁶Gordon, loc. cit.

³⁷Gordon, op. cit., pp. 33 ff.

within the free market, creating five categories of import commodities scaled according to essentiality.³⁸ Allocations of exchange certificates for each category were made by the Government, and weekly auctions were held for each category. The price (or agio) for foreign exchange certificates in a category depended upon the amount of the allocation and the demand. The effective rate of exchange became the agio plus the official parity rate of 18.5 Cruzeiros per U.S. Dollar plus a tax and miscellaneous fees. The period from purchase of the exchange certificates until actual receipt of the exchange in practice has varied according to the availability of foreign exchange, reaching as much as five months in the late 1950's.³⁹

In substance, this new system abolished the old license system of import control and replaced it with a multiple exchange rate system. The effect was to devalue the cruzeiro relative to other currencies and establish markets that helped to equate the supply of and demand for foreign exchange. Additionally, it tended to eliminate windfall profits of importers.⁴⁰

Subsequent regulations under the system established by Law No. 1,807 lifted the restrictions on capital transfers

³⁸Fink, op. cit., p. 49; and United States Department of Commerce, op. cit., p. 151 ff.

³⁹Gordon, op. cit., pp. 17 & 18.

⁴⁰Ibid.

and profit remittances and created a free exchange rate for these transactions and other invisible transfers. Two other types of special rates were similarly created. Special preferential rates were assigned to certain absolutely essential import items such as wheat, newsprint, paper, petroleum products, and fertilizers.⁴¹ Another type of preferential rate, inappropriately termed the "cost of exchange" rate, was established under regulations subsequent to Law No. 1,807, and provided that utility companies, Government agencies, and certain other groups were exempt from the necessity of purchasing their exchange requirements at auction. Instead, such groups would pay a fixed agio based on the average "cost of exchange" to the Banco do Brasil for their proven requirements. Initially, this agio was established at 7.00 Cruz-eiros per U.S. Dollar, but in 1954 it was increased to 15.00, and again in 1955 it was increased to 25.00, making the effective exchange rate 43.82 cruzeiros per dollar--the sum of the official parity rate of 18.82 and the agio. At this rate, the special groups were permitted to finance and service registered loans of at least a five year maturity for the importation of equipment essential to the development of the economy,⁴² and, until 1957, repatriate earnings on

⁴¹Gordon, op. cit., p. 19; and United States Department of Commerce, op. cit., p. 153.

⁴²Fink, op. cit., p. 49; and Gordon, loc. cit.

registered equity capital.⁴³ For the foreign-owned utilities, the preferential rate for importation and the remittance of interest and earnings was a break, while it lasted, in the face of declining profits.

In 1957, through the issuance of Law No. 3,244 of August 14, 1957, and Decree No. 42,280 of December 16, 1957, new foreign exchange and customs systems were put into effect. The new law reduced the number of auction categories from five to two. The general category, which received the greater amount of exchange certificate allocations, included raw materials, producer goods, and consumer goods in short supply domestically. Imports in the special category included goods of restricted consumption such as those already produced in satisfactory quantities, and required licenses for importation. Instruction 166 of the Superintendency of Money and Credit, issued on October 4, 1958, continued the preferential rate previously in existence under the 1953 system, consisting of a fixed agio plus the official parity rate, for imports of equipment considered essential to economic development or national security. Equipment for expansion of electric power facilities was included in the types of items allowed under this rate.⁴⁴ The preferential rate was

⁴³American & Foreign Power Company Incorporated, Thirty-Fourth Annual Report, 1957 (New York: American & Foreign Power Company Incorporated, 1958), p. 27.

⁴⁴Gordon, op. cit., pp. 20-22; and United States Department of Commerce, op. cit., pp. 151 ff.

also continued for the servicing of registered foreign loans of utilities. Dividend remittances abroad from utilities, however, were moved from the preferential rate which they had enjoyed since 1953 to the free rate reserved for capital transfers and other invisibles, which was appreciably higher in terms of Cruzeiros per Dollar than the preferential rate. This had no effect on profits booked to equity in Brazil, but it had significant effects on profits booked to parent companies abroad. The preferential rate had been 51.32 Cruzeiros per Dollar, while the free rate was 119 Cruzeiros per Dollar as of April 18, 1958.⁴⁵

The new 1957 system also revised the application of duties on imports. The specific duties which had previously been in effect but had become meaningless because of inflation were replaced by ad valorem duties which were scaled according to essentiality of the item being imported. Items already produced in Brazil in sufficient quantity or goods considered luxuries were assigned protective duties. Legislative exemption from duties has from time to time been granted for certain products or enterprises. For example, material used in the manufacture of automatic telephone exchanges was granted a five year exemption from duties effective December 10, 1959 by Law No. 3,683 of December 9, 1959.⁴⁶

⁴⁵American & Foreign Power Company Incorporated, Thirty-Fourth Annual Report, 1957, op. cit., p. 27.

⁴⁶Gordon, op. cit., pp. 21 ff; and United States Department of Commerce, loc. cit.

An important revision was made effective in the exchange market on March 14, 1961. Instruction 204 of the Superintendency of Money and Credit of March 13, 1961 abolished the use of an official parity rate and eliminated the auction market for commodities in the general category, shifting them to the free exchange market. Imports in the special category continued to require licenses and exchange auctions. Transactions made at the preferential rate--imports of items considered essential to economic development such as electric power equipment, remittances of interest and amortization on registered foreign debt of utilities, and other specified transactions--continued for a short period, but the preferential rate was increased from one-hundred Cruzeiros per U.S. Dollar to two-hundred. At the same time, other legislation, as mentioned above in this chapter, canceled the automatic electric power rate adjustments that had compensated those utilities for increased costs of servicing registered foreign debt as the preferential rate increased. This new legislation also made such rate changes subject to prior approval by the Minister of Mines and Energy. In July, 1961, the preferential rate was abolished altogether, and transactions formerly conducted at that rate were shifted to the free market. Since the free market rate was appreciably higher than the preferential rate (282 Cruzeiros per Dollar in April, 1961, versus 200 for the preferential rate), this

change in the system made it more difficult for the foreign utilities to service their foreign debts.⁴⁷

From the 1961 revision of the foreign exchange control system to early 1964, Brazil's foreign exchange position continued to deteriorate. In January, 1964, the Superintendency of Money and Credit made it more difficult to obtain foreign exchange. Certain goods in the general category and goods in the special category thereafter required a deposit, amounting to 200 percent of the Cruzeiro cost of the exchange needed, in order for the importer to obtain foreign exchange contracts, such deposits being held by the Banco do Brasil for 210 days in the form of six month, non-interest bearing notes. In the presence of uncontrolled inflation, depositors potentially faced considerable devaluation in the value of their deposits.⁴⁸ These efforts to conserve foreign exchange by making it, in effect, more expensive apparently were not sufficient. American & Foreign Power Company recently reported that, "For all practical purposes, exchange cover for

⁴⁷Gordon, loc. cit.; United States Department of Commerce, loc. cit.; American & Foreign Power Company Incorporated, Thirty-Seventh Annual Report, 1960, loc. cit.; and American & Foreign Power Company Incorporated, Thirty-Eighth Annual Report, 1961, loc. cit.

⁴⁸"Brazilian Government Restricts Foreign Exchange Expenditures," International Commerce, 70:20, January 13, 1964.

financial remittances has been virtually unobtainable for the past few years".⁴⁹

V. CONCLUSIONS

Out of the complicated array of regulations affecting electric light and power and telephone utility operations in Brazil, certain key points emerge.

First, the Brazilian regulatory system, as established by law, used historical cost of investment less depreciation as the regulatory rate-making base. Utility prices were adjusted so that operators would recover operating expenses, allowances for depreciation of the historical value of assets, and an annual return on investment that was a fixed percentage of the historical rate base.

The intent of this system, as specified in various versions of the Brazilian Constitution, was to assure utility operators an adequate return on their investment, a return that would permit improvement and expansion of services. As will be seen in the next chapter, this intention was not realized, for there is a fundamental flaw in this basic system. When both the rate base and rate of return formulae are specified by law, the rate-making process is unable to adapt to unusual situations. In Brazil, the unusual situation was inflation. As inflation advanced in

⁴⁹American & Foreign Power Company Incorporated, Annual Report 1963 (New York: American & Foreign Power Company Incorporated, 1964), p. 18.

Brazil, the historical value progressively understated the actual replacement value of investment. In consequence, investors received profits that in no way reflected the real value of their investment. In other words, the real value of profits calculated on an historical rate base declined. In addition, it should be noted, allowances for depreciation of the historical value of investment no longer reflect the actual needs for replacement of retired plant when there is an inflationary environment. Thus, the flaw in the Brazilian regulatory system tended to prevent utility enterprises from generating sufficient internal funds to attend to the needs of improvement and expansion of services. Furthermore, it tended to discourage infusion of new capital from outside sources.

The Brazilian rate-making formula is not an unusual one, for it is used in parts of the United States, as noted in the beginning of this chapter. The difference in its successful application, however, lies in its administration. When the formula is prescribed by law, there is no flexibility in meeting the unusual situation such as inflation in Brazil. When the formula is prescribed by the regulatory commission, both the rate base and the rate of return can be adjusted to meet the circumstances.

Second, the administration of utility regulation in Brazil has been on an ad hoc basis, as pointed out by Marvin S. Fink in his study.⁵⁰ The establishment of the regulatory

⁵⁰Fink, op. cit., p. 46.

formulae by law is one example of this. The long delay in even the partial implementation of the Code of Waters is a second example. The delays experienced by utility operators in obtaining rate increases to cover only increases in operating expenses is a third example. Administration of the Brazilian regulatory system seems to have been geared toward the immediate requirements of the situation, while the highly important needs for long range planning were largely ignored. A small amount of foresight would have revealed the basic flaw in the system.

Certain regulatory developments were so lacking in foresight that they could only have been motivated by political reasons. For example, two separate laws for the revaluation of assets to account for inflation were passed during the 1950's. In both cases, however, utilities were not permitted to take advantage of the provisions of the laws, even though it was becoming evident that the basic regulatory flaw was hindering utility development in Brazil. There is no evidence in the material presented in this chapter to indicate the reasoning of the Brazilian Government in these instances. However, there is evidence in the realm of political developments in Brazil to indicate what that reasoning might have been. Chapter V of this thesis will explore the political factors that contributed to the ad hoc nature of the regulatory system.

Third, responsibility for the administration of the Brazilian regulatory system was placed in the executive branches of government, and their decisions were not subject to judicial review. The executive branches of any popularly elected government are political bodies that, for the most part, respond to the demands of the populace and expediency. There is little guarantee that such bodies will attend to long range planning in addition to the short term requirements of politics. The Brazilian system of administration of regulation carried the inherent risk that decisions might be based on political expediency with little regard for long range consequences. Without judicial review of decisions, this risk was compounded.

There is, of course, no perfect method of regulation. The method of administration used in the United States, however, is a good point of comparison with the Brazilian system. In the United States, regulatory officials are appointed by the executive branches of government, but thereafter those officials can work without regard for the short term demands of the voting populace, for their decisions are not subject to review by the executive branches. Instead, their decisions can be reviewed and changed only by judicial branches of government, which tend to consider the rights and interests of all parties. Hence, regulatory decisions tend to ignore the requirements of political expediency and concentrate on

the requirements of long range developmental planning and the needs of utility investors who supply the capital for development.

Fourth, the foreign exchange system in Brazil exposed both domestic and foreign-owned utilities, especially the latter, to further complicating factors.

For one, for a number of years, the foreign-owned utilities were in effect subsidized by being permitted to service their capital transactions at preferential rates of exchange. There is no readily available evidence to indicate why the Brazilian Government chose to compensate for the flaws in its regulatory system in this manner instead of correcting the flaws themselves. However, this may be an example of political expediency at work. Given that the populace was opposed to rate increases for utilities, which will be discussed in Chapter V, and that the Brazilian Government might have been thinking of the long range needs of utility investors, then the Government might have elected to maintain a semblance of utility profitability by imposing a subsidy that was essentially invisible to the population. This type of arrangement is ultimately no better than that established in the administration of the regulatory system. There are no more checks and balances on the decisions of executive authorities controlling the foreign exchange markets than there are on the decisions of the regulatory

authorities operating in executive branches of government without judicial review. The riskiness of this arrangement was made evident when the subsidies were recently abolished.

For another, which is all too obvious, profits booked to parent companies of foreign-owned utilities in Brazil were dependent on the foreign exchange situation of the country. As noted in this chapter, Brazil has been experiencing recurrent exchange crises ever since the end of World War II, making capital transfers of utilities sometimes difficult. The exchange situation compounded the risk inherent in the subsidy arrangements. The subsidies were not only dependent on the discretion of the exchange authorities, but also dependent on the health of the foreign exchange market.

Finally, it should be noted that the Brazilian regulatory system posed the possibility of compensation at historical cost rather than current replacement value in the event that utility assets were expropriated or otherwise reverted to the governing authorities. This factor cannot be viewed as encouraging to utility investors, particularly in view of a regulatory system that was contributing to a deteriorating situation, as will be seen in the next chapter.

Many aspects of the points outlined above may have had a bearing on either decisions made by utility investors or decisions made by the Brazilian Government. For example, the foreign-owned utilities were probably all too aware of

the risks inherent in the Brazilian regulatory structure.
The impact of factors such as these will be considered in
Chapter VII.

CHAPTER IV

INADEQUACY OF PROFITS AND SERVICES OF UTILITIES IN BRAZIL

In the previous chapters, we have delineated the nature and extent of investment in Brazilian electric light and power and telephone utilities and the regulatory framework in which the utilities operated. Here we focus on the difficulties utilities experienced under the regulations, and their effect on the quality of service provided.

Brazilian utilities, prior to regulation, were providing adequate service. After thirty years of regulation, they provided inadequate service, because, as profits dwindled, they were unable to generate sufficient internal sources or draw upon sufficient external sources of funds for needed expansion and improvement. This chapter will demonstrate that earnings became inadequate, that funds for expansion of privately owned utilities became scarce as a result, and that services, once adequate, became woefully inadequate.

I. EARNINGS PERFORMANCE OF UTILITIES IN BRAZIL

The best way to portray the earnings performance of utilities in Brazil is to examine Cruzeiro values of earnings

and equity of the various enterprises over time. Unfortunately, this type of data have not been reported, and alternative means of portraying the earnings performance of Brazilian utilities are used in this chapter. Specifically, Dollar values of investment and earnings are used in cases for which this type of information is available. In order to circumvent the distortions of foreign exchange rate conversions, additional indications of earnings performance as viewed from Brazil are included.

The most complete data available for Brazilian Traction, Light and Power Company, Limited (Brazilian Traction) are consolidated income and balance sheet figures, in Dollars, of the parent company for various years. This type of information is highly pertinent for Brazilian Traction stockholders, but it is of limited utility in examining the profitability of utility enterprises in Brazil. First, through consolidation, the contributions of various, different utility enterprises in Brazil are lost. For example, in 1953, electric power generation accounted for 53 percent of Brazilian Traction's revenues, telephone operations for 29 percent, tramway service for 9 percent, and gas sales for 9 percent.¹

Second, in Chapter III it was pointed out that capital could be supplied to Brazilian utility investments through

¹Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960), p. 52.

registered debt which, until recently, could be serviced at a preferential rate of foreign exchange. In addition, utility rates could be adjusted, also until recently, to take account of changing foreign exchange costs of servicing that debt. Understandably, parent companies might have preferred debt investments over equity, which did not enjoy these advantages. Hence, it would be desirable to portray Brazilian Traction's debt and equity investments in its Brazilian subsidiaries, and the respective returns to each, in order to examine the effects of those regulatory provisions on investments and profits. Unfortunately, the consolidated statements do not disclose that type of information.

Brazilian Traction did use the debt form of investment to a significant degree. For example, in 1949, the total consolidated assets of Brazilian Traction amounted to \$571 million, nearly all of it in Brazilian subsidiaries. Roughly \$165 million of this amount had been provided by Brazilian Traction through the purchase of debt securities issued by the subsidiaries.² The balance had been provided by Brazilian Traction investment in equity securities of the subsidiaries, by direct suppliers of credit and debt to the subsidiaries, or by minority shareholders. Of course, the holdings of the parent company were, in turn, held by owners

²Moody's Public Utility Manual 1950 (New York: Moody's Investor Service, Incorporated, 1950), pp. 1121 ff.

of Brazilian Traction's own debt and equity securities. In 1962, total consolidated assets of Brazilian Traction amounted to \$1.1 billion; roughly \$295 million of this amount was held by the parent company through debt securities of the subsidiaries.³ For both years, comparable Dollar figures for the amount of Brazilian Traction's equity holdings in Brazil are not available.

Third, consolidated statements expressed in Dollars distort the earnings picture of Brazilian investments not only because of foreign exchange conversions but also because of sundry financial manipulations of the parent company.

Nonetheless, consolidated statements do indicate a declining earnings performance as viewed by the Brazilian Traction shareholder. Table VIII and Table IX below, abstracted from consolidated statements, contain data relevant to shareholder capital accounts of Brazilian Traction for the years 1942 through 1962. Table VIII shows the book values of the stockholders' net worth, broken down according to historical value of paid in capital and surplus. Table IX reveals: Brazilian Traction's net income, composed of interest and dividends from its debt and equity holdings in Brazilian subsidiaries, available to shareholder accounts-- that is net income after deduction of all taxes, shares of income accruing to minority stockholders, interest on external

³Moody's Public Utility Manual 1963 (New York: Moody's Investor Service, Incorporated, 1963), pp. 1712 ff.

debt of parent and subsidiaries, etc.; the percentage of net income to total capital stock and surplus; the percentage of net income to total capital stock alone; and the increase in surplus accounts for each year.

These two tables clearly show that the rate of return to total shareholder equity declined from a high of 12 percent in 1952 to a low of 0.2 percent in 1962. In fact, by 1962, the rate of return of net income to capital stock alone had fallen to 0.7 percent, even though reinvested earnings represented the bulk of the shareholders' total equity.

But, even these figures are illusory. Over the years, Brazilian Traction retained a high proportion of its earnings in its subsidiaries. For one, this is evident from the surplus account portrayed in Table VIII. For another, between 1946 and 1953, Brazilian Traction made cash expenditures of \$374 million for the expansion of its Brazilian operations. Roughly 34 percent of these funds were supplied through retained earnings, approximately 29 percent were supplied through increases in debt, and the balance was derived from increases in various reserves and write-offs of retired plant.⁴ Prior to 1953, for accounting purposes, all earnings were booked in Dollars through conversion at the single rate of foreign exchange then in effect for all transactions --the official rate of 18.72 Cruzeiros per U.S. Dollar.

⁴Fink, op. cit., p. 56.

TABLE VIII

CONSOLIDATED CAPITAL STOCK AND SURPLUS OF BRAZILIAN TRACTION,
 LIGHT AND POWER COMPANY, LIMITED, 1942-1962
 (Millions of U.S. Dollars)^x

YEAR	TOTAL CAPITAL STOCK AND SURPLUS PER BOOKS	NET EQUITY PER BOOKS	SURPLUS PER BOOKS ^y
1942	199.3	179.8	19.5
1943	207.2	179.8	27.4
1944	216.3	179.8	36.5
1945	225.7	179.8	45.9
1946	235.4	179.8	55.6
1947	247.3	179.8	67.5
1948	260.3	179.8	80.5
1949	278.6	179.8	98.8
1950	298.5	179.8	118.7
1951	322.2	181.6	140.6
1952	350.0	181.8	168.2
1953	363.3	182.5	180.8
1954	375.1	183.2	191.9
1955	393.6	183.2	210.4
1956	416.8	184.1	232.7
1957	424.0	184.9	239.1
1958	425.3	184.9	240.4
1959	432.1	184.9	247.2
1960	443.6	184.9	258.7
1961	512.3	184.9	327.4
1962	509.4	184.9	324.5

^xNot including minority interest in subsidiaries.

^yRetained earnings converted to Dollars at appropriate exchange rate for year retained.

Source: Moody's Public Utility Manual 1945 (New York: Moody's Investor Service, Incorporated, 1945), pp. 822 ff;
Moody's Public Utility Manual 1950, pp. 1121 ff;
Moody's Public Utility Manual 1955, pp. 1458 ff;
Moody's Public Utility Manual 1960, pp. 1375 ff; and
Moody's Public Utility Manual 1963, pp. 1712 ff.

TABLE IX

EARNINGS TO EQUITY PERFORMANCE OF BRAZILIAN TRACTION,
 LIGHT AND POWER COMPANY, LIMITED, 1942-1962
 (Millions of U.S. Dollars)^x

YEAR	NET INCOME BOOKED TO TOTAL CAP- ITAL STOCK AND SURPLUS ^y	SURPLUS FOR YEAR	PERCENTAGE OF INCOME TO TOT- AL CAPITAL STOCK AND SURPLUS	PERCENTAGE OF INCOME TO TOTAL CAPI- TAL STOCK
1942	16.1	9.7	8.1	8.9
1943	19.2	7.9	9.3	10.7
1944	21.9	9.1	10.1	12.1
1945	22.2	9.4	9.8	12.3
1946	23.1	9.7	9.8	12.8
1947	26.0	11.9	10.5	14.4
1948	27.1	13.0	10.4	15.0
1949	31.8	18.3	11.4	17.7
1950	33.0	19.9	11.0	18.3
1951	35.2	21.9	10.9	19.3
1952	42.2	27.6	12.0	23.2
1953	21.0	12.6	5.8	11.5
1954	19.8	11.1	5.3	10.8
1955	18.5	18.5	4.7	10.1
1956	36.1	22.3	8.7	19.6
1957	26.4	6.4	6.2	14.3
1958	11.1	1.3	2.6	6.0
1959	10.0	6.8	2.3	5.4
1960	16.9	11.5	3.8	9.1
1961	16.8	68.7	3.3	9.1
1962	1.2	(2.9)	0.2	0.7

^xNot including minority interest shares of income;
 not including interest paid on long term debt.

^yRetained and unretained earnings converted to Dollars,
 at respective, appropriate rates of exchange.

Source: Moody's Public Utility Manual 1945 (New York:
Moody's Investor Service, Incorporated, 1945, pp.
822 ff; Moody's Public Utility Manual 1950, pp. 1121
ff; Moody's Public Utility Manual 1955, pp. 1458 ff;
Moody's Public Utility Manual 1960, pp. 1375 ff; and
Moody's Public Utility Manual 1963, pp. 1712 ff.

When multiple rates of exchange were created in 1953, Brazilian Traction collected and booked remitted earnings at the preferential rate of 18.72 Cruzeiros per Dollar then available for earnings transfers of utilities, and booked unremitted earnings at the free rate of 40.95 Cruzeiros per Dollar, resulting in a composite rate of 30.02 Cruzeiros per Dollar for the 1953 earnings.⁵ Since the composite rate was appreciably higher than the rate used prior to 1953, earnings booked in Dollars declined significantly, from 12 percent of total capital stock and surplus in 1952 to 5.8 percent in 1953. By failing to remit all of its earnings prior to 1953, Brazilian Traction experienced a considerable opportunity loss when new rates of exchange were created. In addition, as mentioned in Chapter III, the old rate of exchange had been set too low by Brazilian authorities, creating an artificially high level of demand for imports and discouraging exports. This meant that Brazilian Traction was able to book more Dollar earnings than it would have been able to had the authorities set a rate of exchange realistically equating supply and demand of foreign exchange. Hence, the earnings performance of Brazilian Traction prior to 1953 was really overvalued, representing, in effect, a subsidy through the exchange markets.

⁵Ibid., pp. 51-52.

Before leaving the shareholder accounts of Brazilian Traction, additional information should be introduced to relate them to the total capital structure of the company. In 1962, in addition to the shareholder investment indicated in Table VIII, there was roughly \$96 million of external debt of the parent company, roughly \$123 million of external debt of the subsidiaries, and \$34 million of minority equity.⁶ Comparable figures for 1953 were \$105 million of external debt of the parent, some \$30 million of external debt of the subsidiaries, and \$3 million of minority equity.⁷

A limited amount of Cruzeiro data is available to indicate the declining profitability of Brazilian Traction's subsidiaries. Income statements have been reported in Cruzeiros for two of Brazilian Traction's subsidiaries--the Rio de Janeiro Tramway, Light and Power Company, Limited and its affiliate the Brazilian Hydro Electric Power Company, Limited (together known as "Rio Light"), and the Sao Paulo Light and Power Company, Limited (known as "Sao Paulo Light"). In the case of Rio Light, between the end of 1949 and the end of 1953, electric plant in service increased from U.S. \$95 million to \$200 million, or by 110.8 percent. During the same period, total plant, including construction in progress, increased from U.S. \$121 million to \$232 million, or

⁶Moody's Public Utility Manual 1963, loc. cit.

⁷Fink, op. cit., p. 50.

by 91.9 percent. All new plant capacity, as it was brought into service, was immediately absorbed by unsatisfied demand. Therefore, one would have expected roughly proportionate increases in revenues and operating expenses. Between 1949 and 1953, operating revenues increased from 565 million Cruzeiros to 782 million Cruzeiros, or by 38.5 percent. Operating expenses, however, increased from 246 million Cruzeiros to 442 million Cruzeiros, or by 63.5 percent. During the same period, net operating income, after taxes but before depreciation, increased from 319 million Cruzeiros to 340 million Cruzeiros, or by only 6.4 percent. The increase in earnings calculated before depreciation, when translated into Dollars at the official rate of exchange, amounted to only 1.04 percent of the new plant brought into service in that period.⁸

Sao Paulo Light had a similar, although not as dramatic, experience during the same period. The Dollar value of plant in service increased by 47.7 percent, and total plant, including construction in progress, increased in value by 42.9 percent. Total operating revenues increased from 741 million Cruzeiros to 1,090 million Cruzeiros, or by 47 percent. Operating expenses rose from 278 million Cruzeiros to 522 million Cruzeiros, or by 88 percent. Hence, net operating income, after taxes but before depreciation, increased

⁸Ibid., pp. 54-55.

from 463 million Cruzeiros to 568 million Cruzeiros, or by only 23 percent.⁹

In both of these examples, the decline of profitability, especially on new investment, can be attributed to the failure of operating revenues to grow as rapidly as expenses. It should be noted that this occurred even before the onset of rapid inflation in the late 1950's. It should also be noted that the rate of return on new plant investment, when converted to Dollars, was consequently low, as illustrated by the case of Rio Light.

The earnings performance of American & Foreign Power Company Incorporated (AMFORP) was similar to that of Brazilian Traction. In this case, the parent company had utility investments in other countries besides Brazil, so that consolidated statements are of no value in determining the profitability of Brazilian investments alone. However, Dollar figures of AMFORP's debt and equity holdings in Brazilian subsidiaries, and the return to each, are available.

Table X below depicts the cash costs of AMFORP's equity investments in Brazil and the annual return to those investments for the years 1940 through 1961. Cash costs of equity investment include the costs of the securities themselves, incidental investigation and acquisition costs, the

⁹Ibid.

value of reinvested dividends and interest, the amount of cash advances to subsidiaries for construction, and the like. The cumulative values of stock dividends, amounting to \$8 million in 1961,¹⁰ are not included in this table. This type of information, of course, does not include minority interests in subsidiaries.

It can be seen from Table X that the rate of Dollar return to equity was never spectacular, but, in recent years, it distinctly deteriorated, dropping to 0.4 percent in 1961 from a high of 4.3 percent in 1952.

This situation, although not good, was not as bad for AMFORP as these figures might indicate. The consolidated capital structure of AMFORP's subsidiary holding company, Brazilian Electric Power Company (BEPCO), which was the medium of most of the parent company's Brazilian investment, shows why. In 1953, the total capitalization of BEPCO was U.S. \$209 million. Long term debt amounting to \$103 million accounted for 49 percent of the total, capital stock and related surplus belonging to minority shareholders of subsidiaries and amounting to \$35 million accounted for 17 percent, common stock of BEPCO owned by AMFORP amounting to \$59 million accounted for 28 percent, and earned surplus amounting to \$12 million accounted for 6 percent.¹¹ Much of

¹⁰ American & Foreign Power Company Incorporated sources.

¹¹ Fink, op. cit., p. 59.

TABLE X

EARNINGS PERFORMANCE OF AMERICAN & FOREIGN POWER COMPANY
INCORPORATED EQUITY HOLDINGS IN BRAZILIAN SUBSIDIARIES
1940-1961
(Thousands of U.S. Dollars)^x

YEAR	END OF YEAR COST OF EQUITY INVEST- MENTS IN SUBSID- IARIES ^y	NET INCOME BOOKED TO EQUITY INVEST- MENTS ^z	PERCENTAGE OF INCOME TO EQUITY
1940	51,919	984	1.9
1941	51,911	859	1.7
1942	51,911	980	1.9
1943	53,210	976	1.9
1944	53,608	948	1.8
1945	54,768	1,327	2.4
1946	59,630	1,812	3.2
1947	63,559	1,867	3.0
1948	64,158	1,909	3.0
1949	66,845	2,192	3.3
1950	61,935	2,389	3.7
1951	60,071	2,448	4.0
1952	63,354	2,650	4.3
1953	62,041	2,646	4.2
1954	62,506	2,305	3.7
1955	71,336	930	1.4
1956	80,222	1,781	2.4
1957	81,967	2,126	2.6
1958	81,979	998	1.2
1959	81,979	762	0.9
1960	81,433	612	0.7
1961	81,432	291	0.4

^xAll figures exclude minority interests. Conversions from Cruzeiros to Dollars made at exchange rates appropriate to transactions.

^yEnd of year cost of equity investments defined as cash costs of equity securities, reinvested dividends and interest, acquisition expenses, etc. Stock dividends are not included.

^zAfter deductions for Brazilian withholding taxes, etc.; includes subsidiary holding companies.

Source: American & Foreign Power Company Incorporated.

BEPCO's outstanding long term debt was held by AMFORP, although exactly how much has not been reported. In 1953, AMFORP held \$52 million of debt securities of its Brazilian subsidiaries.¹² Since the apparent policy of AMFORP was to book such transactions through BEPCO, it can be presumed that this figure approximated the indebtedness of BEPCO to AMFORP. Hence, a considerable part of the capitalization of AMFORP's subsidiaries represented debt, much of it held by AMFORP, and interest on such debt constituted an important part of AMFORP's income from Brazil.

It should be noted from these capitalization figures that BEPCO's retained earnings were small in relation to debt. Although the consolidated capital accounts of BEPCO and Brazilian Traction cannot be compared directly, because the former represented an intermediate holding company with indebtedness to its parent not netted out of its statements while the latter represented a parent with internal indebtedness netted out of its statements, one notes that surplus in 1953 accounted for 36 percent of Brazilian Traction's consolidated capitalization, as can be calculated from data given previously, while in the same year it amounted to only 6 percent of BEPCO's capitalization.

Apparently, AMFORP preferred, more than Brazilian Traction, to withdraw its earnings on equity and reinvest a

¹²American & Foreign Power Company Incorporated sources.

portion of these as debt--which, if registered, enjoyed preferential treatment in foreign exchange transactions and in determination of utility rates until recently. At the end of 1961, the cash costs, as defined above, of AMFORP's total investments in Brazil amounted to \$147 million. Equity investments accounted for \$81 million of this amount, and debt investments accounted for \$66 million. Of the debt portion, some \$52 million or 79 percent of the total was registered.¹³

The presence of this debt has acted as a brake on the decline of AMFORP's earnings. Table XI below gives the cash costs of AMFORP's debt investments in Brazil and the Dollar return to these investments for the years 1940 through 1961. Table XII below gives the cash costs of AMFORP's total investments in Brazil and the Dollar return to the total for the same years. When viewed in conjunction with Table X above, these two tables show that the relatively stable and adequate return to debt partially offset the decline in AMFORP's earnings on its total investment. Nonetheless, aggregate performance of these investments was poor, never being spectacular, but falling off to a total rate of return of 3.0 percent in 1961.

Unlike subsidiaries of Brazilian Traction, subsidiaries of AMFORP kept their books in Cruzeiros, and Cruzeiro statements of some of those subsidiaries have been reported for

¹³Ibid.

TABLE XI

EARNINGS PERFORMANCE OF AMERICAN & FOREIGN POWER COMPANY
INCORPORATED DEBT HOLDINGS IN BRAZILIAN SUBSIDIARIES
1940-1961

(Thousands of U.S. Dollars)^x

YEAR	END OF YEAR COST OF DEBT INVEST- MENTS IN SUBSID- IARIES ^y	NET INCOME BOOKED TO DEBT INVEST- MENTS. ^z	PERCENTAGE OF INCOME TO DEBT
1940	51,872	2,418	4.4
1941	51,242	2,633	5.1
1942	51,622	2,708	5.3
1943	49,017	2,812	5.6
1944	47,111	2,044	4.3
1945	47,582	2,435	5.1
1946	46,988	2,495	5.3
1947	50,820	2,525	5.7
1948	58,629	2,906	5.3
1949	53,681	3,284	5.8
1950	49,320	3,006	5.8
1951	51,031	2,651	5.3
1952	55,134	2,807	5.3
1953	52,242	2,733	5.1
1954	51,740	2,814	5.4
1955	50,628	2,606	5.1
1956	52,374	3,082	6.0
1957	56,478	4,895	9.0
1958	60,604	4,400	7.5
1959	65,043	3,980	6.3
1960	65,927	4,388	6.7
1961	66,325	4,191	6.6

^xAll figures exclude minority interests. Conversions from Cruzeiros to Dollars made at exchange rates appropriate to transactions.

^yEnd of year cost of debt investments defined as cash costs of debt securities and acquisition expenses.

^zAfter deductions for Brazilian withholding taxes, etc.; includes subsidiary holding companies.

Source: American & Foreign Power Company Incorporated.

TABLE XII

EARNINGS PERFORMANCE OF AMERICAN & FOREIGN POWER COMPANY
INCORPORATED TOTAL HOLDINGS IN BRAZILIAN SUBSIDIARIES
1940-1961

(Thousands of U.S. Dollars)^x

YEAR	END OF YEAR COST OF TOTAL INVEST- MENTS IN SUBSID- IARIES ^y	NET INCOME BOOKED TO TOTAL INVEST- MENTS ^z	PERCENTAGE OF INCOME TO DEBT
1940	103,791	3,402	3.2
1941	103,153	3,492	3.4
1942	103,533	3,688	3.6
1943	102,227	3,788	3.7
1944	100,719	2,992	2.9
1945	102,350	3,762	3.7
1946	106,618	4,307	4.1
1947	114,379	4,392	4.2
1948	122,787	4,815	4.1
1949	120,526	5,476	4.5
1950	111,255	5,395	4.7
1951	111,102	5,099	4.6
1952	118,488	5,457	4.8
1953	114,283	5,379	4.6
1954	114,246	5,119	4.5
1955	121,964	3,536	3.0
1956	132,596	4,863	3.8
1957	138,445	7,021	5.2
1958	142,583	5,398	3.8
1959	147,022	4,742	3.3
1960	147,360	5,000	3.4
1961	147,758	4,482	3.0

^xAll figures exclude minority interests. Conversions from Cruzeiros to Dollars made at exchange rates appropriate to transactions.

^yEnd of year cost of total investments defined as cash costs of equity securities, debt securities, reinvested dividends and interest, acquisition expenses, etc. Stock dividends are not included.

^zAfter deductions for Brazilian withholding taxes, etc.; includes subsidiary holding companies.

Source: American & Foreign Power Company Incorporated.

earlier years by Marvin S. Fink and Staff.¹⁴ Capitalization and earnings figures for one of AMFORP's subsidiaries are reported again here in order to illustrate the illusion of profitability that arises when earnings performance is calculated on a historical cost base. The reader interested in greater detail for this and other AMFORP subsidiaries should consult the study cited.

Companhia Paulista de Forca e Luz (Paulista), a subsidiary of AMFORP through BEPCO, operated in over 260 communities in the State of Sao Paulo, covering an area of roughly 32,000 square miles. At the end of 1953, it had an installed generating capacity of 92,600 kilowatts, completely hydroelectric, representing approximately 35 percent of the installed capacity of AMFORP's Brazilian operations. In addition, the company operated street railway service in one community.¹⁵

As of December 31, 1953, the Brazilian public owned 48.5 percent of Paulista's common stock, AMFORP's subsidiary holding company BEPCO owned 42.0 percent, and the Southern Brazil Electric Company, Limited owned 9.5 percent. The latter company, in turn, was owned 95 percent by BEPCO, giving BEPCO 51.5 percent of Paulista's voting stock. Nearly all of the stock held by the Brazilian public was issued

¹⁴Fink, op. cit., 85 pp.

¹⁵Ibid., pp. 21-22.

between 1945 and 1953.¹⁶

Table XIII below gives, in Cruzeiros, capitalization and earnings figures of Paulista for the years 1949, 1950, 1953, and 1954. For all years, gross income as a percentage of total capitalization and net income as a percentage of common stock equity indicated a good earnings performance. For example, the return to common stock equity in 1954 was 12.7 percent. This performance was typical of other AMFORP subsidiaries, when statements were reported in Cruzeiros.

This performance was an illusion. Under the Brazilian regulatory system, the rate of return to investment was restricted to 10 percent of a historical cost base. The capitalization and earnings statements of Paulista reflect good earnings performance when based on book, or historical, value of capitalization. However, the Cruzeiro purchasing power of those earnings in current prices was a different matter. For example, between 1949 and 1954, the cost-of-living index in Brazil rose from 25 to 50.¹⁷ If the total common stock equity of Paulista in 1949, amounting to 256.9 million Cruzeiros, was revalued upward, according to the cost-of-living index, to the 1954 level, and the amount of the revaluation was added to the 1954 total common stock

¹⁶Ibid., pp. 59-61.

¹⁷International Financial Statistics (Supplement to the 1963-1964 edition; Washington: International Monetary Fund, April, 1964), pp. 22-24.

TABLE XIII

COMPANHIA PAULISTA DE FORÇA E LUZ: CAPITALIZATION
AND EARNINGS FOR THE YEARS 1949, 1950, 1953, AND 1954
(Millions of Cruzeiros)

	1949	1950	1953	1954
<u>CAPITALIZATION</u>				
Debt	368.7	309.9	491.4	609.0
Common Stock Equity:				
Common Stock	223.0	367.6	673.0	673.0
Legal Reserve	7.7	12.2	27.3	32.8
Surplus	<u>26.2</u>	<u>57.1</u>	<u>122.4</u>	<u>160.3</u>
Total Common Stock Equity	<u>256.9</u>	<u>436.9</u>	<u>822.7</u>	<u>866.1</u>
Total Capitalization	<u>625.6</u>	<u>746.8</u>	<u>1314.0</u>	<u>1475.1</u>
<u>EARNINGS</u>				
Gross Income	70.0	96.3	144.0	167.4
% of total Capitalization	11.2	12.9	11.0	11.3
Net Income	38.2	69.3	112.9	109.9
% of Common Stock Equity	14.9	15.9	13.7	12.7

Source: Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960), pp. 59-61.

equity of 886.1 million Cruzeiros, a new equity figure of roughly 1,123 million Cruzeiros would result. Net income booked to this new figure would reflect a rate of return of 9.8 percent instead of 12.7 percent. This adjustment, of course, is a crude effort to make the 1954 figures reflect their 1954 replacement value. Actually, the 1949 equity figure would have to be revalued considerably more in order to reflect different times of investment, and the new rate of return calculated above would be even smaller.

Another measure of the decline of purchasing power of earnings occurs when Cruzeiro values of plant are compared to values in a more stable currency such as Dollars. In 1961, AMFORP reported that its investment in physical plant in Brazil was made at an average rate of exchange of 70 Cruzeiros per U.S. Dollar. However, the April, 1961, free exchange rate was 282 Cruzeiros per Dollar.¹⁸ This meant that earnings reckoned on the historical value of investment made at 70 Cruzeiros per Dollar had less value when transferred abroad at a higher exchange rate. Since much of the equipment needs for expansion of plant had to be purchased abroad, ability to finance expansion was impaired.

Unfortunately, similar data for the telephone operations of International Telephone and Telegraph Corporation

¹⁸American & Foreign Power Company Incorporated, Thirty-Seventh Annual Report, 1960 (New York: American & Foreign Power Company Incorporated, 1961), p. 13.

(ITT) in Brazil cannot be presented, because the company has not made such figures available. ITT has made similar claims, however, with respect to their earnings. Their Brazilian Telephone Company, Companhia Telefonica Nacional, is alleged to have earned an average rate of return on its Dollar investment of only 3.1 percent between 1955 and 1959. ITT reports that in 1960 and 1961 there were "Dollar losses"¹⁹ (presumably meaning Cruzeiro losses as well). According to one commentator on the ITT expropriation case in Rio Grande do Sul, in years immediately proceeding the 1962 expropriation, ITT was not even earning enough on its operations in that State to recover depreciation allowances.²⁰

In spite of the lack of adequate data for ITT's Brazilian operations, their claims are consistent with the experience of the electric utility operators, and are consistent with the probable effects of the regulatory structure under which ITT operated. There is one difference, however, and that is the losses ITT claims to have experienced. The electric utility operators were earning some, although small, profits. The reason for the difference probably lies

¹⁹International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, (New York: International Telephone and Telegraph Corporation, 1962), p. 8.

²⁰The Hon. E. Ross Adair, "Expropriation and Foreign Aid Funds," Public Utilities Fortnightly, 69:586-94, April 26, 1962.

in the fact that ITT's Brazilian subsidiary operated under State administration of regulation, while electric utility operators operated under Federal administration.

It is important to note that Brazilian utility operators had a similar earnings performance. With respect to the numerous, small electric utility enterprises owned and operated by Brazilians, the Joint Brazil-United States Economic Development Commission noted: "These enterprises are in a majority of cases in a precarious financial condition because their profitability has been more seriously impaired than that of any other sector of the industry by the reluctance of the authorities to grant speedy rate adjustments in the face of inflationary increases in operating costs."²¹

Comparison of utility earnings performance relative to other Brazilian industries puts the problem in better perspective. Such comparisons have been made for electric light and power utilities, and are presented in Table XIV below. From this table, it can be seen that in the period 1948 through 1952--prior to the subsequent, marked deterioration of electric utility earnings performance that occurred in the late 1950's--manufacturing enterprises were enjoying a rate of return on net worth far greater than the return realized by utility operators. Even these figures, however,

²¹Joint Brazil-United States Economic Development Commission, The Development of Brazil (Washington: U. S. Government Printing Office, 1954), pp. 172-73.

understate the disparity between the rates of return. To compensate for inflation, manufacturing corporations were allowed to revalue their assets upward according to official coefficients provided for by Law No. 1,474 of November, 1961. Many firms revalued their assets, but utilities were not permitted to do so. As a result, the rate of return for

TABLE XIV

AVERAGE RATES OF RETURN TO NET WORTH FOR BRAZILIAN
CORPORATIONS FROM 1948-1952

	1948	1949	1950	1951	1952
Manufacturing	13.2%	12.9%	17.3%	18.8%	12.8%
Electric Utilities	7.5	9.0	9.8	9.6	9.2
General Average all Corporations	13.6	13.5	14.4	17.9	13.4

Source: David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), p. 30.

utilities was overvalued, representing the return to an historical cost base that in no way reflected current replacement value. If the utilities had been permitted to revalue their assets, their rate of return would have been significantly smaller.²² Since Table XIV does not reveal the true state of affairs, comparison with data from another country

²²David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), pp. 29-30.

such as the United States would not be meaningful.

A recent study sponsored by AMFORP dramatizes the performance of electric utilities relative to other Brazilian industries in a different way. In this study, a Brazilian investment firm, Deltec S.A., presented a report entitled "Comparison of the Results of Investment in Industrial Companies with those in Public Utility Companies", the public utility companies primarily representing AMFORP subsidiaries. This report showed that a person who invested in representative stocks of industrial and commercial firms in Brazil in 1948 would have experienced by 1958 a 63 percent increase in the real value of his investments and a 78 percent increase in the purchasing power of his dividends, while an investor in utility companies, during the same ten year period, would have experienced a 77 percent decrease in the real value of his investments and a 74 percent decrease in the purchasing power of his dividends.²³

Before leaving this discussion of utility earnings performance, it should be noted that the return to new investment was no better than the return to existing investment, as noted in the case of Brazilian Traction's subsidiary Rio Light. AMFORP has reported that in 1946 its total investment --debt, stocks, and surplus--in Brazil amounted to \$105 million and earned a rate of return of 5.6 percent or nearly

²³American & Foreign Power Company Incorporated sources.

\$5.9 million. At the end of 1960, the equivalent Dollar investment, including reinvested earnings in the form of capitalized stock dividends, amounted to \$154 million, representing an increase of some \$49 million over a fourteen year period. However, applicable earnings had increased by only \$865 thousand to roughly \$6.8 million. The return to total investment declined to approximately 4.4 percent. The increase in earnings in relation to the increase in investment reflected a rate of return of only 1.75 percent on the new investment.²⁴

II. DISCOURAGEMENT OF UTILITY INVESTMENT

The earnings performance of Brazilian public utilities was dismal. One would expect, therefore, reluctance on the part of private capital suppliers to contribute to the improvement and expansion of electric light and power and telephone utilities.

Other than looking at the effects of regulation on past profits, the potential investor also looked ahead. The National Economic Council of Brazil, which was charged by the President of Brazil to formulate a new regulatory system for electric light and power utilities, noted in 1952 that:²⁵

It is not the limitation of profits which dissuades private capital from being invested in these

²⁴Ibid.

²⁵Revista do Conselho Nacional do Economia, Aug-Sept, 1952, p. 7, cited by Fink, op. cit., pp. 45-46.

services, not the 10 percent dividend which is manifestly low in comparison with the return from capital invested elsewhere. The fundamental point lies in the unchangeable basis from which this percentage is reckoned and which reduces the value of the return all the time, as the currency depreciates.

Looking at the regulatory system from another point of view, the Council also observed that: "The remote, yet always existing danger of expropriation against an indemnity for the invested capital on the basis of the original historical cost creates unsatisfactory conditions not permitting the formation of reserve funds which would protect capital against depreciation of currency and give sufficient margin for the expansion of the undertaking."²⁶

In addition, as Marvin S. Fink points out in his study, "There has been a aura of uncertainty concerning the regulation of the industry, with the result that regulation has been largely on an ad hoc basis."²⁷ Such uncertainty could only have affected investment decisions adversely.

Before examining the effects these conditions had on capital sources, two points should first be noted. First, new investment in Brazilian utilities did not cease altogether. For example, between 1945 and 1960, AMFORP increased its debt and equity holdings in Brazil from \$102 million to \$145 million, or by 45 percent, as can be seen from Table XII

²⁶Ibid.

²⁷Fink, op. cit., p. 46.

above. Brazilian Traction, during the same period, increased its net equity and surplus from a total of \$226 million to \$444 million, or by 97 percent, as can be seen from the consolidated capital accounts given in Table VIII. In addition, AMFORP and its subsidiaries went into debt to the Export-Import Bank of Washington by \$40 million as part of a \$213 million expansion program.²⁸ Between 1949 and 1953 alone, Brazilian Traction increased long term debt from 13 percent of its total capitalization to 27 percent, largely through loans obtained from the International Bank for Reconstruction and Development aggregating \$118 million. These loans were used to finance the foreign exchange requirements of the company's construction program.²⁹

Second, when earnings of an enterprise are inadequate, operations do not generate sufficient funds for expansion. Table XV below depicts the sources of funds Brazilian Traction used in financing plant expansion amounting to \$374 million from 1946 through 1953. Debt, mostly from the International Bank for Reconstruction and Development, accounted for roughly 29 percent of the total, and retained earnings accounted for roughly 34 percent. Even if Brazilian Traction had retained all of its earnings during that period, aggregating roughly \$200 million (see Table IX), it still could

²⁸American & Foreign Power Company Incorporated sources.

²⁹Fink, op. cit., p. 51.

TABLE XV

SOURCES OF FUNDS OF BRAZILIAN TRACTION, LIGHT
AND POWER COMPANY, LIMITED, 1946-1953
(Millions of U.S. Dollars)

	AMOUNT	PERCENTAGE
Retained Earnings	125.1	33.6
Increase in Depreciation Reserve	61.1	16.4
Increase in Funded Debt	109.8	29.4
Increase in "General Reserve"	30.2	8.1
Increase in "Provision for Amortization"	22.6	6.1
Write-offs of Retired Plant	<u>24.1</u>	<u>6.4</u>
Total Sources:	372.9	100.0
Cash Expenditures on properties ^y	374.4	

^yReflects conversion of Cruzeiro expenditures at 18.72 Cruzeiros per U.S. Dollar up to 1953 and at 30.02 Cruzeiros per U.S. Dollar for 1953.

Source: Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960), p. 56.

not have financed the expansion without external debt. Hence, it was imperative for utilities to be able to draw upon external sources of capital.

Private suppliers of capital were not willing to supply the quantity of funds required in either debt or equity form. Investors in Brazil purchased some equity securities of utilities, but the experience demonstrated how thin the Brazilian capital markets were. For one example, in 1953, a Brazilian-owned utility--Companhia Sul Mineira de Eletricidade, which had an installed electric power generating capacity of 17,496 kilowatts--attempted to increase its outstanding common stock by 75,000,000 Cruzeiros, but the company was able to raise only 8,911,380 Cruzeiros.³⁰ For another example, AMFORP, between 1942 and 1954, actively solicited the participation of local capital in its subsidiaries, and sold in excess of the equivalent of \$20 million of common stock to over 6,500 investors, resulting in public ownership of roughly one-quarter of the AMFORP subsidiaries' equity. In spite of the large amount raised, AMFORP was not encouraged, and the firm felt that further solicitation would not have been successful. The Deltec Report mentioned previously dramatized what the Brazilian investor in shares of AMFORP subsidiaries experienced--namely, a decline in the value of his investment. AMFORP believed that the only reason for the

³⁰Ibid., p. 73.

initial success was the greater stability of Brazilian currency then than in more recent years.³¹ Finally, electric utility enterprises in Brazil from 1948 to 1952 were able to raise only one-fortieth to one-tenth as much funds from private Brazilian investors as manufacturing enterprises, and the funds so raised did not even represent a proportionate share according to the value of their existing assets.³²

Suppliers of equity in foreign countries were equally as reluctant to invest in Brazilian utilities as Brazilian investors were. For example, one would have expected that the large reinvestment of earnings of Brazilian Traction between 1946 and 1953 would have increased the market value of the company's stock. However, both the dividends paid per share and the market value decreased. In 1953, Brazilian Traction common stock had a book value of roughly \$30 per share, but the market quotation was only about \$7.50 per share. At the same time, electric utility stocks in the United States had market values of approximately 150 percent of book value.³³

Private purchasers of utility debt securities in Brazil or foreign countries have not supplied large quantities of funds either. AMFORP, in its expansion of its

³¹American & Foreign Power Company Incorporated sources.

³²Cavers and Nelson, op. cit., p. 31.

³³Fink, op. cit., p. 57.

Brazilian facilities between 1946 and 1960, raised essentially no funds through the issuance of debt securities in Brazil.³⁴ Brazilian Traction, in the financing of expansion between 1946 and 1953, issued debt securities for the most part to the International Bank for Reconstruction and Development, but very few, if any, to Brazilians.³⁵ Parent companies were able to place some debt securities in foreign countries. For example, between 1946 and 1960, AMFORP raised \$68 million through long term borrowing in the United States, but this amount was distributed among all of its Latin American operations. A large portion of this amount was realized through a \$53 million issue of debentures, but the Export-Import Bank of Washington subscribed to \$25 million of these, the balance being subscribed to by private capital.³⁶ When one considers that the portion supplied by private capital had to be distributed to AMFORP subsidiaries in several Latin American nations, it becomes clear that private capital was in effect supplying only a small portion of AMFORP's Brazilian expansion program. One notable example illustrated the difficulties of placing debt securities for Latin American utility development. In August, 1959, after Castro had come to power in Cuba, AMFORP issued \$15 million of convertible

³⁴American & Foreign Power Company Incorporated sources.

³⁵Fink, op. cit., p. 51.

³⁶"A U.S. Company in a Latin Squeeze," Fortune, 65:101-3, February, 1962.

debentures in the United States, the bulk of the proceeds being designated for refinancing debt of AMFORP's Cuban subsidiary. The same week, the Cuban Government slashed electricity prices by 22 percent, forcing AMFORP to withdraw the debentures from the market.³⁷

One potential source of funds for Brazilian utility development by private investors was the Federal Government of Brazil. However, this source did not constitute a major supplier. Between 1946 and 1960, the Banco Nacional de Desenvolvimento Economico (BNDE) loaned AMFORP and its subsidiaries the equivalent of only \$8 million, or roughly 4 percent of the companies' expansion funds. Even BNDE funds were difficult to obtain. In 1958, the Export-Import Bank loaned AMFORP roughly \$11 million on the understanding, agreed to by BNDE representatives, that BNDE would loan the AMFORP subsidiaries a Cruzeiro counterpart, in excess of the subsidiaries' own resources, amounting to 750 million Cruzeros. The Export-Import Bank loan materialized; the BNDE loan did not, because AMFORP and the BNDE were unable to agree on terms.³⁸

As it should now be apparent, the major suppliers of funds for Brazilian utility expansion, besides the utilities themselves, have been international banks. Between 1948 and 1959, the International Bank for Reconstruction and

³⁷Ibid.

³⁸American & Foreign Power Company Incorporated sources.

Development (IBRD) loaned \$536 million to electric power enterprises, some of them government-owned, in nine Latin American nations. Brazilian enterprises, chiefly Brazilian Traction subsidiaries, were major recipients of these funds. IBRD loans were reported to have added 1.8 million kilowatts of generating capacity in Brazil, representing a 96 percent increase in the country's 1948 total generating capacity. Between 1934 and 1960, the Export-Import Bank of Washington loaned \$242 million to Latin American utility enterprises, some \$88 million going to Brazil, AMFORP subsidiaries being the primary recipients.³⁹

The international banks did not, however, loan such funds without reservation. The President of the IBRD has been reported to have said:⁴⁰

A steadily expanding supply of public utility services is a requisite of economic growth in all underdeveloped countries today. Over the next decade, many thousands of million dollars in capital for these services must be found.

There is simply no practical way to raise money unless a substantial part of it is generated by the utilities themselves through adequate charges to the users of their services. . . especially. . . in a country where there is no organized capital market. By "adequate" rates we have meant rates which enable utilities not only to cover the real cost of their services but also to retain out of earnings substantial sums each year to help finance the expansions which inevitably

³⁹Herbert Bratter, "Latin American Utilities' Nationalization Proceeds Inexorably," Public Utilities Fortnightly, 66:1-15, July 7, 1960.

⁴⁰Ibid.

will be needed to sustain future growth. And we have made no distinction in advocating adequate rates between privately owned and publicly owned utilities.

A representative of the Export-Import Bank has been reported to have made a similar statement:⁴¹

Eximbank's concern with rates is centered almost exclusively on assurance that rates will provide sufficient earning power to secure the loan. At the same time, where rates help produce loan security through earning power, they also make the transaction attractive to potential private investors who may participate with Eximbank in a loan.

In concluding this discussion on the sources of capital for utility expansion in Brazil, we note that private capital sources, exclusive of the funds generated by the utilities themselves, were not available in great supply, and that international lending agencies acted to make up the deficits. All the sources combined, however, were unable to finance expansion at a fast enough rate, so that utilities were unable to provide adequate amounts of services. This will be taken up shortly.

The inadequate earnings and subsequent reduction in financial ability eventually deteriorated to the point whereby the enterprises themselves became reluctant to continue their existing investments. For example, on November 21, 1961 AMFORP initiated negotiations with the Brazilian Federal Government for the sale of their entire utility holdings.⁴²

⁴¹Ibid.

⁴²American & Foreign Power Company Incorporated sources.

III. CAUSES OF DECLINING PROFITABILITY

The cause of the poor earnings performance of Brazilian utilities was the low prices fixed for their services by the Brazilian regulatory authorities. For example, ITT reported comparative monthly rates for residential telephone service in U.S. Dollars, converted at appropriate rates of exchange, as of February 16, 1962, as: \$1.57 in Porto Alegre, Brazil; \$2.00 in Mexico City, Mexico; \$3.17 in Lima, Peru; \$2.72 in Montevideo, Uruguay; \$7.42 in Caracas, Venezuela; \$4.60 in San Juan, Puerto Rico; and \$5.60 in New York City.⁴³ That rates in Porto Alegre were low compared to other cities in other countries is not conclusive evidence that they were too low to provide ample revenues. An analysis of local costs is necessary, and such is beyond the scope of this thesis. However, when one considers, in addition, that the telephone prices, relative to prices of other items, were falling as inflation advanced, then there is reason to suspect a causal relation between falling profits and falling relative prices. This suspicion would be incorrect if there had been a change in the efficiency of telephone operations, but one can infer that such a change probably did not occur given the climate for utility operations in Brazil. ITT reports that its average revenue per company station climbed

⁴³International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., p. 8.

307 percent from 1955 through 1961.⁴⁴ During this period, the cost-of-living index rose from 50 to 256, or by 402 percent.⁴⁵ According to ITT, labor costs increased appreciably more in this same period.⁴⁶ Thus, the evidence, although not complete enough to be conclusive, supports ITT's claim that the "rate of return from CTN (Companhia Telefonica Nacional) was kept by unrealistic rate regulation to levels that made impossible significant new investment."⁴⁷

The imposition of cheap prices on electricity output was the cause of diminishing profitability in the electric power industry as well. For example, AMFORP subsidiaries from 1930 to 1960 experienced an average revenue per kilowatt-hour increase of roughly six times, whereas in the same period the cost-of-living increased by thirty-four times. In constant prices, this meant that the cost of electricity

⁴⁴Ibid.

⁴⁵International Financial Statistics, loc. cit.

⁴⁶In ITT's report--The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., p. 7--figures are given that show from 1955-1961 labor costs for outside plant station maintenance increased 838%, station installation 716%, and construction 641%. Personnel costs are said to have represented 56% of the operating costs in 1955 and 61% in 1961. The costs given, however, represent costs of construction of new plant more than costs of daily operation, and one cannot, therefore, derive a figure for the percentage increase in operating costs.

⁴⁷International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., p. 8.

decreased by 83 percent during that period. Table XVI below depicts this situation. Note the long run trend that developed before recent pronounced inflation.

TABLE XVI

RELATIVE PRICE OF ELECTRICITY FOR AMERICAN & FOREIGN POWER COMPANY INCORPORATED SUBSIDIARIES IN BRAZIL, 1930-1960

YEAR	COST-OF LIVING INDEX	AVERAGE REVENUE PER KILOWATT-HOUR:		RELATIVE PRICE OF ELECTRICITY
		Cruzeiros	Index	
1930	1.00	0.35	1.00	1.00
1940	1.50	.41	1.17	0.78
1950	5.18	.62	1.77	.34
1960	34.09	2.00	5.71	.17

Source: American & Foreign Power Company Incorporated.

AMFORP calculations made in 1961, projected to December 31 of that year, compared the rates for their Brazilian subsidiaries with rates in other countries. Using an exchange rate of 320 Cruzeiros (Cr.\$) per U.S. Dollar, their figures show that while their Brazilian rates would have been Cr. \$3.30 per kilowatt-hour, average rates elsewhere would be: Cr. \$5.818 in the entire United States; Cr. \$12.480 in Guatemala City; Cr. \$6.333 in Buenos Aires, Argentina; Cr. \$20.292 in Lima, Peru; Cr. \$17.294 in Caracas, Venezuela; Cr. \$6.287 in San Jose, Costa Rica; and other figures higher than in Brazil.⁴⁸

⁴⁸American & Foreign Power Company Incorporated sources.

These data show that electricity prices in Brazil were cheaper than elsewhere, and that the trend of relative prices in Brazil had been downward. Part of the relative decline in Brazilian prices since 1930 represented technological advances. For example, according to the study of Cavers and Nelson, an index of real electrical rates (1939 base equals 100) for industrial consumers in the United States fell from 98 in 1929 to 51 in 1949 and 1954. In Brazil, those indices for industrial consumers fell from 152 in 1929 to 28 in 1949 and 18 in 1954.⁴⁹ Considering the United States as a technologic leader, with sound utility enterprises and a relatively stable currency, one can infer that the decline of real rates in the United States primarily represented the effects of increased efficiency due to technological change and economies of scale. Comparatively, however, real rates in Brazil fell much further, and recently were far lower than in the United States. One might infer that electricity was underpriced in Brazil.

There are serious limitations on this sort of analysis. One can determine whether or not electricity in Brazil was underpriced only in relation to the costs of producing it, and the data for such an analysis are not available. The decline in real electricity prices in Brazil greater than the decline in the United States might have reflected, to

⁴⁹Cavers and Nelson, op. cit., pp. 69-109.

some extent, both technological advances and a greater opportunity to take advantage of the economies of scale. In 1929, electrical generation in Brazil came from scattered and diverse sources, while in 1954 a large degree of integration was evident. However, given that electricity was very cheap in Brazil, that the cheapness was imposed through the regulatory system, and that under regulation utilities universally experienced a decline in profits until private capital was no longer adequately available, then it is probably safe to say that electricity was underpriced in Brazil to the extent that the regulatory system made no allowance for the cost of capital.

IV. EFFECTS ON SERVICES PROVIDED BY UTILITIES

Cheap utility rates have two consequences. First, demand for the services is accelerated, and, second, utility operators are deprived of the financial means to expand at rates needed to keep pace with growing demand. The inevitable consequence is inadequate service.

Electricity is a vital element of industrial development, and the shortages of electricity in Brazil have been accorded considerable attention with respect to economic development. From 1900 to 1930, generating capacity in Brazil increased from roughly 12,000 kilowatts to roughly 680,000 kilowatts, or an increase of 5,600 percent.⁵⁰ In

⁵⁰ Joint Brazil-United States Economic Development Commission, op. cit., p. 156.

1930, there was adequate capacity to meet demand. Regulation, coupled with the dislocations of the depression and the war years, altered the situation. In 1935, per capita generating capacity was 22 watts, and in 1950, 36 watts, which growth represented a 64 percent increase during that period. Electrical consumption in 1935 was 62 kilowatt-hours per capita, which grew to 160 kilowatt-hours per capita by 1950. This increase was 158 percent of the 1935 figure.⁵¹ Consumption was clearly growing faster than capacity during this period. The validity of this conclusion is evident as well from the average load factors (ratio of actual average production to full capacity production) for the electric power industry in Brazil. In 1940, the load factor was 33 percent; by 1945, it had grown to 41 percent; by 1950, it had reached 50 percent. The increase in load factor created difficulties as it meant that there was insufficient capacity to meet demand peaks. Periods of peak demand were accompanied by the overloading of distribution lines, voltage drops, widespread rationing, and sudden interruption of service. Seasonal variations in hydroelectric water supplies and periodic droughts intensified shortages. In effect, load factors were raised by lopping off demand peaks.⁵²

⁵¹Ibid., pp. 161-162.

⁵²Ibid.

This inadequate power service had an adverse effect on industrial development by discouraging the formation of new industries that required adequate power, by forcing many manufacturers to install expensive power plants of their own, and by creating severe operational problems for enterprises requiring uninterrupted service. The Joint Brazil-United States Economic Development Commission dramatized some of the difficulties thus:⁵³

A maker of the plastic molding material, polystyrene, has a standby diesel generator to prevent complete power failure, but sometimes, this, too, has failed. At such a time the material flowing through the production equipment solidifies, causing a shutdown of no less than 10 days and up to three weeks, while polystyrene is manually chipped out of the vessels.

.

A steel foundry reports that while it plans to install a diesel motor to provide compressed air, it cannot afford diesel generated electric power for its electric furnaces. Light company power costs this foundry about Cr. \$0.14 per Kwh, while it calculates that the total cost of diesel power, including amortization of equipment, would come to about Cr. \$1.30 per Kwh, or nearly 10 times as much.

Power shortages were first officially recognized in 1942. Decree Law No. 4,295 of May 13 of that year empowered the National Council of Waters and Electric Energy to establish rules for electricity rationing.⁵⁴ After the publication of the Joint Commission's 1953 report, the situation did not

⁵³Ibid., p. 158.

⁵⁴Fink, op. cit., p. 110.

improve. In 1958, 9 percent of the country's generating capacity was supplied by industrial self-producers who were hedging against power failures.⁵⁵ These private plants required large foreign exchange requirements for fuel, and represented an inefficient diversion of resources because their output was uneconomical. During a long drought in 1958, AMFORP's subsidiary in Minas Gerais purchased power from certain industrial self-producers in that State to ward off a possible expropriation.⁵⁶ In 1963, power shortages in the former capital city of Rio de Janeiro, served by a subsidiary of Brazilian Traction, resulted in rationing that required a 10 percent reduction in industrial power consumption and a 20 percent reduction for all other users. At that time, the Rio de Janeiro power company estimated that its generating capacity was 100,000 kilowatts short of peak demand requirements.⁵⁷

In a message to the National Congress on March 15, 1961, President Quadros stated that installed generating capacity in service had reached 4.6 million kilowatts, that 2.1 million kilowatts of capacity were under construction, but that

⁵⁵United States Department of Commerce, Brazil (Washington: U.S. Government Printing Office, 1961), p. 110.

⁵⁶American & Foreign Power Company Incorporated, Thirty-Sixth Annual Report, 1959 (New York: American & Foreign Power Company Incorporated, 1960), p. 14.

⁵⁷"Darkness in Rio", Time, 81:45, May 24, 1963.

an additional 1.3 million kilowatts would be required to reach the estimated requirements of 8 million kilowatts of capacity by 1965.⁵⁸ If recent experience is any measure, shortages will persist. The President's estimates required the addition of 3.4 million kilowatts of capacity in a five year period, representing a 74 percent increase in the 1961 capacity or an average annual increase of 14.8 percent of the 1961 level. However, between 1955 and 1958, during which consumption rose 43 percent, installed generating capacity rose only 24 percent, or an average annual increase of 6 percent of the 1955 level.⁵⁹ The President's estimates required a rate of expansion more than twice as great as in recent years, and a level of investment that private capital will clearly not support given the present environment.

Given these electric power shortages, and the rapid industrialization and urbanization that contributed to them, it is not surprising (as noted in Chapter II) that the Federal and State Governments have undertaken their own power development programs, and that, whereas in 1945 there were no public companies except a few, small municipal ones, in 1958 public companies accounted for 14 percent of the country's installed generating capacity, with the percentage

⁵⁸United States Department of Commerce, op. cit., pp. 108-9.

⁵⁹Ibid.

rising as more new projects were brought into service.⁶⁰ Public investment, however, failed to halt the decline of utility services.

The telephone situation, although not as well documented, was as bad as the electric power situation. In 1959, there were an estimated 800,000 persons waiting for telephone service.⁶¹ Former President Kubitschek, in a speech and press conference in March, 1962, at Harvard University, stated that in one Brazilian city, some 10,000 persons had waited 10 years for telephone service, and had still not received it. "If I lived in one of those cities," he continued, "and wanted a phone for my yet unborn grandson, I'd order it now."⁶²

As a result, a widespread black market for telephones appeared. A customer could sell his telephone and his telephone listing on the black market, which charged \$100 for an extension and \$500 for a private telephone completely installed and with its own set of forged documents. Telephones were rarely returned to the companies when a customer abandoned his service. When 4,000 government employees transferred from the old capital, Rio de Janeiro, to the new one, Brasilia, several years ago, fewer than 100 surrendered

⁶⁰Ibid., p. 110.

⁶¹Ibid., p. 142.

⁶²Christian Science Monitor, March 8, 1962, p. 7.

their telephone service to the Companhia Telefonica Brasileira, a subsidiary of Brazilian Traction. The rest were sold on the black market.⁶³

Even for the telephones in use, service was generally bad, being the worst during hours of peak demand. Long distance connections took hours to complete, if completed at all. In Rio de Janeiro, recently, it took two minutes to obtain a local connection. In Sao Paulo, a long rain reduced the chances of getting the correct connection by a half.⁶⁴ Wrong numbers were obtained more frequently than busy signals in one city.⁶⁵

V. CONCLUSIONS

In closing this chapter, significant points emerge, which, in conjunction with the previous chapters, conclude the discussions of the utility operations themselves. The foreign-owned utilities, which dominated electric light and power and telephone services in the Brazilian infrastructure, clearly were subjected to rate regulation that greatly reduced the profitability of the utility enterprises, reduced internal sources of funds and external sources of debt and

⁶³"Hot Line," Newsweek, 62:79, October 21, 1963.

⁶⁴Ibid.

⁶⁵"More on the Brazilian Telephone Situation", Public Utilities Fortnightly, 71:60-61, May 9, 1963.

equity capital needed for expansion, and, inevitably, caused deterioration of the utility services. It should be noted that private Brazilian-owned utilities had the same experience. In addition, the decline in utility performance relative to the needs of the Brazilian economy was not a recent occurrence resulting from the pronounced inflation in the late 1950's and early 1960's. Rather, it first became evident shortly after World War II when inflation was less severe, although progressive. Nor did the decline imply the cessation of private utility investment. Expansion and improvement of services did continue, but could not, as a result of the reduced financial capabilities of the enterprises, progress as rapidly as the demands imposed by the Brazilian economy required.

It was pointed out in Chapter II that, for a number of reasons, the foreign-owned utilities were inviting targets for political intervention. Chief among these reasons were the very nature of utility services themselves, the dominating size of foreign-owned utilities, their importance in connection with past and future development, and the inherent uneasiness created by the presence of foreign capital in any host country's infrastructure. In Chapter III it was argued that intervention, in part, came in the form of an ad hoc regulatory system that, given the inflationary environment, made it virtually impossible for utilities in Brazil,

foreign or domestic, to thrive. It was pointed out that the basic flaw of this system was its inability to take account of an unusual situation, such as an inflationary environment, because rate-making was fixed by law to an historical cost formula. The significance of that flaw is now clear. Utilities have experienced what has been termed "creeping expropriation", for as earnings diminished, so did the intrinsic value of the enterprises. But, beyond this, and more importantly, the deterioration of services attracted national concern, as manifested by studies such as that of the Joint Brazil-United States Economic Development Commission. This additional attention only enhanced the risk of further political intervention in the name of national development or security.

CHAPTER V

BRAZILIAN ATTITUDES TOWARD UTILITIES

The Brazilian regulatory system restricted the profits of electricity and telephone utilities to the point that their health was endangered, their services became inadequate, and their operations were no longer able to service the needs of economic development. A healthy and expanding infrastructure is a prerequisite to industrial development, yet Brazilian policy, officially devoted to development, discouraged expansion of utility services. One wonders why the Government did not pursue a policy conducive to the growth of utility services--namely, a policy that permitted an adequate, yet reasonable, rate of return, enabling the utilities to generate internal sources of funds or draw upon external sources of private capital in order to meet the needs of expansion.

I. POLITICAL NATURE OF THE RATE PROBLEM

The answer is not ignorance of the plight of the utilities. There is ample evidence to show that Government leaders knew regulatory policies were strangling the utilities. The 1952 National Economic Council of Brazil reported

to the President that the lack of adequate profits was discouraging new utility investment.¹ The Joint Brazil-United States Economic Development Commission reported the same in 1953.² President Kubitschek in a 1958 message to Congress supporting the revaluation of utility assets for rate-making purposes under Law No. 3,470 of the same year, stated:³

The persistence of an unrealistic tariff policy, in what regards capital remuneration, has already determined the deterioration of innumerable public services, to the point of obliging the State to assume the responsibility of operating them, receiving virtually bankrupt entities, whose operation, in anti-economical conditions, constitute a heavy onus to the National Treasury, and consequently, to all Brazilian taxpayers.

The answer to why the Government pursued a policy destructive to privately owned utilities and, apparently, to the national interest in terms of economic development, can only lie in Brazilian politics, the intricacies of which are well beyond the scope of this thesis. However, this chapter

¹Revista do Conselho Nacional do Economia, August-September, 1952, p. 7, cited by Marvin S. Fink and Staff, Reports on Electric Power Regulation in Brazil, Chile, Colombia, Costa Rica and Mexico (Cambridge: Harvard Law School, 1960), p. 45.

²Joint Brazil-United States Economic Development Commission, The Development of Brazil (Washington: U.S. Government Printing Office, 1954), pp. 154 ff.

³Presidential Message 186 of 1958, Diario do Congresso, December 3, 1958, p. 2,602, cited by International Telephone and Telegraph Corporation, Untitled reply of February 26, 1962, to Court Order of February 16, 1962, confirming Rio Grande do Sul Decree No. 13,186 of February 16, 1962, that expropriated International Telephone and Telegraph Corporation property in that State, p. 57.

will attempt to reveal some of the Brazilian attitudes toward utilities, and some of the major sources of political discontent that led to those attitudes and their expression.

II. FACTORS CONTRIBUTING TO POLITICAL UNREST

An understanding of political unrest in Brazil rests upon certain basic economic and social changes that have occurred in the recent past. As mentioned in Chapter II, Brazil has been experiencing substantial economic development in recent decades. The country has moved from the position of importer of most nonagricultural goods to a position of self-sufficiency in most light industries and many heavy ones. Between 1949 and 1959, gross domestic product in constant prices (base year, 1949) rose from 217.4 to 385.9 billions of Cruzeiros, amounting to an average annual increase of 5.8 percent. The index of real product during that period rose to 177.5 from 100 in 1949. In per capita terms, the index of gross domestic product rose from 100 in 1949 to 140.3 in 1959, representing an average annual increase of 3.4 percent.⁴ In 1958, per capita gross national product, expressed in U.S. dollars, stood at \$250, as compared with \$2,324 in the United States.⁵ Most of the gains have been made by the industrial sector of the economy.

⁴United States Department of Commerce, Brazil (Washington: U.S. Government Printing Office, 1961), p. 5.

⁵Yearbook of National Account Statistics 1963 (New York: United Nations, 1963), pp. 321 ff.

Industry's share of the internal production national income rose from 21.9 percent in 1949 to 24.6 percent in 1958,⁶ and the index of industrial production rose from 100 in 1949 to 235.1 in 1958.⁷

Although its share in the national income has been diminishing, agriculture has remained the most important sector of the economy, principally because of coffee exports. In 1958, agricultural production accounted for 26.1 percent of the internally produced national income.⁸ In recent years, coffee has accounted for roughly 60 percent of the value of the country's exports, and, consequently, the coffee export market has been an important element in the determination of Brazil's foreign exchange position. It is significant to note that the United States has been Brazil's chief coffee customer, purchasing 56.5 percent of the value of Brazil's coffee exports in 1960.⁹

Brazil has been plagued by two major economic problems: chronic inflation and balance of payments deficits. The cost-of-living index (base year, 1958) rose from 5.62 in 1937 to 25 in 1948, to 50 in 1954, to 73 in 1956, to 100 in 1958, to 185 in 1960, and to 390 in 1962. In recent years,

⁶United States Department of Commerce, op. cit., pp. 5-6.

⁷Ibid., p. 115.

⁸Ibid., p. 6.

⁹Ibid., pp. 157 ff.

inflation has approached runaway proportions. For example, the 1962 cost of living was 152 percent of the 1961 figure. Since World War II, balance of payments deficits have been chronic, chiefly because of an unfavorable balance of trade. In the fifteen years between 1948 and 1962, imports exceeded exports in U.S. dollar values ten of those years. Between 1957 and 1962, there were only deficits, amounting to \$96 million in 1957, \$193 million in 1960, and \$261 million in 1962.¹⁰ Consequently, Brazil has been faced with recurrent foreign exchange crises.

The final economic factor of importance in relation to this chapter is the substantial involvement of foreign capital in Brazilian economic development, as noted in Chapter II. A 1959 survey placed capital and reserves of foreign-owned enterprises in Brazil at an equivalent of U.S. \$3.5 billion. The participation of foreign capital in total private and public investment in Brazil was estimated as 31 percent in 1959 and 32 percent in 1960. United States investments accounted for the greatest portion of foreign capital, amounting to 37.5 percent in 1959, with Canadian investments in second place at 17.7 percent, primarily representing holdings of Brazilian Traction, Light and Power Company, Limited. United States Department of Commerce data for 1960 listed

¹⁰International Financial Statistics (Supplement to the 1963-1964 edition; Washington: International Monetary Fund, April, 1964), pp. 22-24.

United States investments in Brazil, with net working capital devalued to reflect depreciation of the Cruzeiro, at \$953 million. Of this amount, \$200 million, or 21 percent of the total, represented investment in public utilities.¹¹ As will be seen, the large investment of foreign capital in Brazil has proved to be a source of friction between Brazilians and foreigners.

Brazil's rapid economic growth has caused substantial demographic changes in the population, with a definite trend toward urbanization. In 1940, 68.8 percent of the total population of 41,236,315 persons was classified as rural.¹² By 1950, the population had grown to 51,944,397, but the portion classified as rural had declined to 63.8 percent.¹³ According to the most recent census, the rural portion had declined further to 54.9 percent of a total population of 70,967,185 persons by 1960.¹⁴ As these figures imply, population growth of cities has occurred at a rate much faster than the country as a whole. Between 1950 and 1960, population for the country as a whole grew by 37 percent of the

¹¹United States Department of Commerce, op. cit., pp. 11-14.

¹²Demographic Yearbook 1948 (New York: United Nations, 1948), p. 215.

¹³Demographic Yearbook 1955 (New York: United Nations, 1955), p. 190.

¹⁴Demographic Yearbook 1962 (New York: United Nations, 1962), p. 308.

1950 population figure. The population of principal Brazilian cities during the same period grew: 90 percent in Belo Horizonte, 65 percent in Porto Alegre, 56 percent in Recife, 40 percent in Rio de Janeiro, and 57 percent in Sao Paulo.¹⁵

The rapid growth of cities in Brazil has reflected a changing social structure. As one commentary points out, between 1940 and 1950, the active population in cattle raising and agriculture increased only 4.6 percent, while the active population increased 59.4 percent in manufacturing, 134.2 percent in services, and 38.9 percent in commerce, transportation, and communications. This means class structures have been realigning, with a growing urban proletariat and middle class.¹⁶

III. TENSIONS, ASPIRATIONS, AND FRUSTRATIONS IN BRAZIL

These social and demographic changes have contributed significantly to internal tensions in Brazil. Another commentator has identified some of the problems.¹⁷ First, population growth in the cities has caused the urban centers

¹⁵Demographic Yearbook 1955, op. cit., p. 175; and Demographic Yearbook 1962, op. cit., pp. 328-29.

¹⁶L. A. Costa and Waldemiro Bazzanella, "Economic Development, Social Change and Population Problems in Brazil," Annals of the American Academy of Political and Social Science, 316:121-6, March, 1958.

¹⁷T. Lynn Smith, "The Giant Awakes: Brazil," Annals of the American Academy of Political and Social Science, 334: 95-102, March, 1961.

to bulge with masses of ill-housed, poorly educated, and impoverished people unable to cope effectively with city life. Second, the industrial boom has whetted the appetites of Brazilians for even better standards of living; that is, the levels of aspiration have been raised above those within immediate economic reach. Third, economic difficulties and shortages of many of the necessities of modern life have exacerbated the frustrations arising from the increased levels of aspiration.

The majority of the migrants to the cities have come from backward, rural areas of the country, and, of any population segment, have been the least equipped to deal with the demands of city life. Politically, educationally, economically, culturally, and socially, they have been unprepared. To them, city life has meant life in the unskilled work force, their homes comprising the slums of the urban areas. Most significantly, perhaps, the traditional family and social ties have been broken through migration to the cities, leaving these people in a state of confusion and readiness to join any organization that seems capable of replacing the ties.¹⁸

The frustrations of these people and of all Brazilians have been increased by the rising level of aspirations that occurs when any society emerges into the modern world. Portions of the population that were never before exposed to

¹⁸Ibid.

good housing, transportation, communications, education, wages, and the other numerous aspects of modern life have seen these now, and have been made aware of the further improvements within their grasp through comparisons with other socio-economic groups, the standard of living of foreigners in Brazil, and the achievements of other nations.¹⁹ In view of these frustrations, it is not surprising to find that Brazilians have been preoccupied with their economic development. The successful rallying cry of President Kubitschek's administration was "Fifty years of progress in five".²⁰

Conditions in Brazil have made these frustrations more intense. Desires for rapid economic development and a higher standard of living have been thwarted by several obstacles. Rapid inflation in Brazil has made it increasingly difficult for Brazilians to maintain their standard of living. Government granted wages increases have been followed by sharp rises in the cost of living which, in turn, have been followed by unrest and political pressures for further wages increases, which have been granted, repeating the cycle. The inflationary environment has also helped to discourage foreign and domestic investment. In late 1961, it was estimated that one billion Dollars of Brazilian capital had been

¹⁹Ibid.

²⁰David B. Richardson, "Brazil: Troubled Giant of the Americas," U.S. News and World Report, 48:38-41, February 29, 1960.

invested abroad or deposited in foreign banks. In recent years, the rate of new foreign investment in Brazil has declined sharply.²¹ Many Brazilians in lower economic classes have found it necessary to take on part time jobs in addition to their regular employment in order to maintain their standard of living or supplement their inadequate income.²²

Coupled with the problems arising from inflation have been the scarcities of many commodities and services in the Brazilian economy. Transportation facilities have not been adequately developed, resulting in periodic food shortages in the cities while foodstuffs decayed in the fields in the country. Communications and power have been scarce and uncertain. Foreign exchange difficulties, besides deterring foreign investment, have made it difficult for Brazil to obtain needed commodities such as petroleum products or machinery vital to economic development. Illiteracy has been high, and competent educators and technical personnel have been in short supply. According to the 1950 census, less than 1,000,000 people had completed the equivalent of high school, and, in the entire country, there were less than 160,000 persons with university degrees. In the backward portions of Brazil, the death rate has been high and life

²¹John J. Johnson, "Politics and Economics in Brazil," Current History, 42:89-95, February, 1962.

²²T. Lynn Smith, loc. cit.

expectancy short.²³

Thus, economic growth has indirectly been a source of frustration in Brazil. It has caused fundamental social and demographic realignments that have broken the old social orders and created new ones with attending uneasiness and tension. Along with these changes has been a growing awareness of the economic power Brazil could achieve. Yet, this achievement has been hindered by economic obstacles such as an inadequate infrastructure, inflation, foreign exchange difficulties, and a lack of competent personnel. The resulting frustrations have generated political pressure for the removal of such obstacles.

IV. IMPACT ON RATE-MAKING POLICY

Popular opinion in Brazil has focused on inflation as one of the obstacles to further development. For example, in late 1959, students and police clashed in a riot over sharp price increases at a Government-subsidized student restaurant.²⁴ In fact, during 1959 and early 1960, cost-of-living riots occurred in many Brazilian cities.²⁵

Popular resistance to price increases, as manifested by incidents such as these, has had a contributing influence on

²³Ibid.

²⁴New York Times, January 3, 1960, p. 19.

²⁵New York Times, January 13, 1960, p. 49.

Government rate-making policy for regulated industries in Brazil. Typically, rates for regulated industries have been set too low. For one example, in 1954, the operating deficits of the Federally-owned railroads amounted to five billion Cruzeiros, or 8 percent of the Federal Government's budget, because the rate scale bore no relationship with operating costs.²⁶ For another example, also in 1954, several private concessionaires cancelled their contracts for the provision of water, gas, or tramway services, and turned the services over to municipal authorities because, again, the rates were set too low.²⁷ Finally, in past years the Federal Government of Brazil has repeatedly incurred additional budget deficits in the operation of its coastal shipping lines, ports, automobile plants, and oil companies.²⁸

It is possible that the policy of setting rates too low has been based on the rationale of promoting economic development. To what extent this has been true is difficult to ascertain, for this argument, which has been frequently voiced, could be nothing more than a rationalization of the policy. In addition, it is probable that Government rate-making policy has been ad hoc in nature to the extent that

²⁶David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), p. 43.

²⁷Ibid.

²⁸David B. Richardson, "A Country where Inflation is a Way of Life," U.S. News and World Report, 55:67-69, August 12, 1963.

regulatory officials have been indifferent to the needs for long range planning. Nonetheless, it is true that, in response to strong popular resistance, rate-making authorities have been reluctant to grant regulated industries rate increases for their products or services. For example, the Joint Brazil-United States Economic Development Commission pointed this out in its consideration of electric light and power regulation, and former President Kubitschek, during a 1962 visit to Harvard University, admitted that, in response to public opinion and pressure, authorities were not permitting electric light and power and telephone utility companies to increase their rates.²⁹

It has sometimes been contended that popular resistance to rate increases was motivated by the poor performance of utilities.³⁰ Poor performance has irritated the Brazilian populace. For example, in October, 1958, in a small town in the State of Sao Paulo, a mob set fire and heavily damaged the local power company offices, because they were enraged by frequent electric power failures and rationing.³¹ For another example, in July, 1959, marines were sent to the

²⁹Joint Brazil-United States Economic Development Commission, op. cit., p. 173; and Christian Science Monitor, March 8, 1962, p. 7.

³⁰Joint Brazil-United States Economic Development Commission, loc. cit.

³¹New York Times, October 11, 1958, p. 3.

coffee exporting town of Paranagua to restrain mobs that had burned down the city hall, wrecked two banks, and damaged other buildings in protest of an electric power failure.³²

However, as shown in Chapter IV, it was the rate-making policy that caused the poor performance of the utilities. Government reluctance to grant rate increases has really been in response to popular opposition motivated basically by resistance to inflationary trends, examples of which were given above. Once poor performance occurred, of course, popular opposition increased, making the situation for utilities worse.

Reluctance to grant rate increases has not implied no rate increases at all, but it has implied delays in the granting of rate increases required to offset increases in operating expenses in operating expenses, and it had additionally implied failure to allow for remuneration of capital, as noted in Chapter III.

Hence, popular resistance to price increases has contributed to Governmental reluctance to grant rate increases to utilities. In fact, this reluctance has applied, as is evident from the above examples, to all regulated industries, including utilities, regardless of ownership--public, private, or foreign.

³²New York Times, June 3, 1959, p. 30.

V. GROWTH OF NATIONALISM AND HOSTILITY
TOWARD FOREIGN CAPITAL

Popular opinion, in its search for the obstacles to further Brazilian development, has not focused on inflation alone. In fact, foreign capital and influence, which have dominated the economic sphere of Brazilian life from massive investments to the export markets, have become a major focal point for Brazilian frustrations and political pressure, with grave implications for the foreign-owned utilities in Brazil. Popular opinion has come to believe that progress could be made if only Brazil had control of its own destiny.

This has been manifested in numerous ways. On one level, there has been personal resentment against foreigners, as expressed by one Brazilian banker. According to his complaints, Americans living in Brazil have created ill feelings and made few friends because: they have failed to learn Brazilian customs, they have lived in American colonies and joined American clubs, they have socialized mostly with themselves, they have given the impression that they are interested only in business and not in Brazil, they have failed to learn the language and relied on interpreters even after a prolonged stay, and their wives have failed to make any contribution in the community through social and civic affairs as they do back home.³³

³³The Wall Street Journal, January 28, 1959, p. 8.

On another level, there has been resentment against foreign capital for real and imaginary abuses. Some Brazilian nationalists have claimed, as pointed out by two other observers of Brazil,³⁴ that foreign capital has come to Brazil in hopes of earning an exorbitant profit, and that, rather than contributing to national development, foreign capital has actually hindered development by bleeding the country of its resources through the withdrawal of amounts greater than the original investment. Some nationalists have contended that foreign investment has been concentrated in nonessential consumer products industries rather than in industries required to build a real industrial base. Claims have been made that foreign investment has often been made up of overvalued, obsolete machinery, already fully depreciated in its country of origin. Claims have also been made that foreigners have brought in as little capital as possible, relying heavily on local sources of funds such as Brazilian branches of foreign banks, which have acted as instruments to divert Brazilian savings from domestic investors to foreigners and their less productive projects. Royalties and technical assistance fees have sometimes been viewed as instruments to extract additional profits from Brazil.

Although there have been exceptions, these arguments

³⁴Werner Baer and Mario Henrique Simonsen, "American Capital and Brazilian Nationalism," The Yale Review, 53: 192-98, December, 1963.

have not been supported by facts in most instances. Repatriation of profits has been usually small and reinvestment of earnings high. Much of the investment of foreigners has been concentrated in heavy industries, such as power and automobile production, although consumer items such as Coca-Cola and home appliances have also been produced.³⁵

Foreign capital has neglected some measures that could have been taken to make its presence less noticeable. Public relations efforts directed toward explaining the contributions of foreign enterprises have been largely absent except for advertising explaining the functional usefulness of products. The names of foreign corporations have often remained in the language of the country of origin, and when "Brazil" has been incorporated into the title, it has often been done in that form rather than in the Portuguese equivalent, "Brasil". In many cases, the participation of local equity has not been sought. In addition, cases have been brought to light of attempts to bribe public officials for favors. A large, United States dominated public utilities company is reported to have bribed a substantial number of representatives in a local legislature in order to get a rate increase several years ago. Although Brazilian officials may not have been adverse to taking a bribe, and Brazilian businessmen have been known to bribe public officials themselves, it nonetheless has been highly damaging to the image

³⁵Ibid.

of foreign capital when such instances have been brought out to serve as fuel for nationalist claims.³⁶

It is not surprising to note that United States capital has been synonymous with foreign capital in the eyes of many Brazilians. United States capital has comprised the greatest share of foreign capital in Brazil, and the fact that the United States has been Brazil's biggest coffee customer and an important supplier of aid and credit through its foreign aid programs and the Export-Import Bank has added to the visibility of United States influence in general and United States capital in particular.

Nationalistic feelings have been growing in Brazil as a result of the frustrations and tensions there, and the arguments against foreign capital have gained wide acceptance. The growth of nationalism has been made evident in numerous ways. For one example, in 1952, the Government established the monopoly Petroleo Brasileiro, S.A. (Petrobras) for discovering, developing, and refining petroleum sources. The 1946 Constitution of Brazil had provisions permitting the development of petroleum deposits by private companies. However, nationalistic groups, using the cry "the petroleum is ours", successfully created popular opposition to private development of oil reserves by foreign companies, and Petrobras was established instead.³⁷ Oil refineries already in

³⁶Ibid.

³⁷United States Department of Commerce, op. cit., pp. 105-8.

existence at the time of the creation of Petrobras were permitted to continue under private operators, but these, however, have gradually been incorporated into its operations, sometimes through expropriation measures such as the Presidential Decree of March 13, 1964.³⁸ Brazil is believed to possess large oil reserves, but, under Petrobras, these have not been rapidly developed, so that by 1960 domestic petroleum production of crude oil amounted to only 28 percent of the country's consumption requirements, the balance being imported at a heavy cost of foreign exchange.³⁹

As another example of the growth of nationalism, in 1959, the powerful Labor Party--headed by Joao Goulart, who was then Vice President of Brazil--adopted a platform calling for the nationalization of foreign-owned power companies.⁴⁰

VI. NATIONALISTIC EXPRESSIONS OF POPULAR LEADERS

With the growth of popular nationalistic feelings, there appeared, on yet another level, evidence of hostility toward foreign capital. Prominent nationalistic leaders, in efforts to gain popular appeal, came out publicly with the arguments nationalists expressed against foreign capital. For one example, while Governor of the State of Rio Grande

³⁸New York Times, March 14, 1964, p. 7.

³⁹United States Department of Commerce, loc. cit.

⁴⁰New York Times, May 18, 1959, p. 41.

do Sul, Governor Brizola, who expropriated American & Foreign Power Company and International Telephone and Telegraph Corporation properties in his State, stated in an interview with a U.S. News and World Report reporter:⁴¹

I like Americans. But I do not like American businessmen. They should stay home. . . .All that American businessmen are interested in is making money and exploiting us.

.

Brazil needs capital from abroad. But it also needs to eliminate those foreign capitalists who, for reasons of economic self-interest, compromise Brazil's development and its political sovereignty. The investment we want most of all is that which comes into Brazil with its owners and their families, on a permanent basis. . . .However, it has not been possible to get that kind of investment from the United States. All that come here from the U.S. are subsidiaries of powerful holding companies and economic interests. These operate as an instrument of suction of our wealth--they suck needed capital out of Brazil.

.

But I consider that it is much more important for us to eliminate the exploitive process. Our country serves as a kind of sieve. . . .If we do not block the holes in the sieve, all the money going to Latin America under Alliance for Progress will flow back to the U.S., with dividends.

.

However, we could accept private investment from little countries. . . .Countries, I mean, that have no navy or marines.

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⁴¹David B. Richardson, "How Safe is U.S. Property in Brazil," U.S. News and World Report, 52:43-45, March 26, 1962.

I consider that foreign investment as it is practiced here by U.S. businessmen and supported by the U.S. Government is a form of neocolonialism.

For the most part, charges such as these are not justified. For example, foreign investors have retained a high proportion of their earnings in Brazil, as pointed out previously in this chapter. The point to be noted here is the similarity between these charges and those of other nationalists mentioned above.

Joao Goulart, who served as Vice President under the administrations of Presidents Kubitschek and Quadros and as President between 1961 and 1964, made similar statements, although perhaps not as frequently or passionately as Governor Brizola. In 1957, as Vice President, Goulart spoke in vague terms of "pragmatic nationalism" and "economic emancipation" as the guiding principles of his Labor Party.⁴² In 1959, he stated that the "astronomical" remittances abroad of profits made in Brazil by foreign companies were the cause of the miseries of Brazilian workers. In the same speech, he declared, "the truth is. . .that the Government does not command sufficient legal means to prevent the fruit of the people's sacrifice from being transferred to the pockets of a small minority. . . .The remittance of profits abroad, which is bleeding the Brazilian economy to the advantage of those who still today want to colonize us, never

⁴²New York Times, October 5, 1957, p. 3.

reached proportions as impressive as now."⁴³ As President, Goulart on November 1, 1961, accused foreign groups of blocking basic economic reforms that would tend to free Brazil from underdevelopment, in order to continue enjoying excessive profits that bleed the country.⁴⁴ In other speeches at the same time, he said that foreign companies had been enriching themselves on the "misery and suffering of the Brazilian people".⁴⁵ During a 1962 visit to the United States, President Goulart stated that Brazil wanted to attract foreign capital, but that it was "not interested in predatory or merely speculative capital, which enriches the investor at the cost of sacrifices by the people."⁴⁶

The views of these two nationalistic leaders were among the most outspoken ones of prominent Brazilians. They did not, however, indicate rabid ultranationalistic feelings in the entire Brazilian populace. On the contrary, there were leaders of more moderate or even opposite views who appealed to other segments of the population. The views of these two leaders did indicate that nationalism had a broad popular base in some quarters of the country, a base strong enough to allow such nationalistic appeals.

⁴³New York Times, May 3, 1959, p. 32.

⁴⁴New York Times, November 2, 1961, p. 22.

⁴⁵New York Times, November 5, 1961, p. 37.

⁴⁶New York Times, April 7, 1962, p. 2.

VII. EXAMPLES OF HOSTILITY TOWARD FOREIGN CAPITAL

Nationalistic feelings such as these were transformed into a positive expression of hostility toward foreign capital through the passage of a profit remittance law. In November, 1961, the Chamber of Deputies of the Brazilian Congress passed a bill that would have restricted annual remittances of profits of foreign companies to 10 percent of registered direct investment. Earnings greater than the 10 percent and retained in Brazil were to have been regarded as national capital without remittance rights. Annual repatriation of capital was to have been limited to 20 percent of the registered direct investment, and any remittances in excess of the 10 percent allowance for profits were to have been deemed repatriation of capital, reducing the registered value of direct investment.⁴⁷ The measure also would have required residents of Brazil to register their holdings in foreign countries for tax monitoring purposes in response to nationalists' cries that the wealthy classes were plundering the country.⁴⁸ Another provision of the bill would have barred companies with majority ownership held in foreign countries from official credit sources except under special executive decree. Income tax deductions

⁴⁷"Brazil suspends profit remittances pending capital registration under new law," International Commerce, 68:42, October 22, 1962.

⁴⁸New York Times, November 3, 1962, p. 29.

for payments of royalties and management and technical assistance contracts were to have been limited to 5 percent of sales during the first five years of such arrangements only. Payments of such fees by subsidiaries to parents abroad would have been made illegal.⁴⁹ Restrictions would also have been imposed on the operations of branches of foreign banks.⁵⁰

The effect of such a law would have been to place foreign investment in Brazil in a situation similar to that of the foreign-owned utilities. Registration of direct investment at historical cost would have caused the real value of earnings to fall rapidly with the soaring inflation in Brazil, and the provisions forbidding the registration of retained earnings in excess of the legal profit margin as direct investment would have prevented foreign investors from obtaining some relief in the devaluation of their properties.

The Brazilian Senate modified certain provisions of the measure passed by the Chamber of Deputies. Under the Senate version, remittances abroad on foreign investment would have been limited to 8 percent of paid-in capital only for industries producing luxury goods or services. Restrictions on remittances in other industries would not have been

⁴⁹"Brazilian Business Jolt", Chemical Week, 91:43-4, September 29, 1962.

⁵⁰New York Times, November 30, 1961, p. 10.

imposed except in case of grave foreign exchange crises.⁵¹
 For the purpose of calculating future legal remittances,
 registration of reinvested profits was to have been per-
 mitted.⁵²

Before the final passage of the profits remittance law, the Chamber of Deputies reinserted its more restrictive provisions without removing the liberalizing clauses of the Senate. The Law became effective September 27, 1962, with the ambiguities not cleared up, subjecting the interpretation of the Law to the executive branch of the Federal Government. This interpretation came on October 27, 1963, when President Goulart announced that he wanted the more rigorous provisions applied. With respect to reinvested earnings, the President stated, "The profits in excess of 10 percent, which the law does not permit to be remitted, will have to be considered national capital held by foreigners, and will remain here collaborating in our economic development, but they can not be used to constitute the base for new remittances."⁵³

Shortly after passage of the Law, exchange transactions

⁵¹"Politics and Inflation harass Brazil's economy," International Commerce, 68:42-3, August 20, 1962.

⁵²"Brazil suspends profit remittances pending capital registration under new law," International Commerce, 68:42, October 22, 1962.

⁵³New York Times, October 28, 1963, p. 41.

for profit remittances were suspended pending registration of foreign capital in Brazil. Administrative inadequacies delayed the processing of the registrations, and, hence, the execution of the Law. By the end of October, 1963, it was reported that more than \$100 million of profits were waiting for remittance authorizations.⁵⁴

VIII. IMPLICATIONS FOR FOREIGN-OWNED UTILITIES

The growth of nationalism and hostility toward foreign capital placed the foreign-owned utilities in a particularly uncomfortable position. It has been shown that regulatory authorities have been reluctant to grant rate increases to any regulated industry because of strong popular opposition to inflationary trends. In the case of the foreign-owned utilities, adequate rate increases were all the more unlikely because of the growth of nationalism. Regulatory authorities reluctant to grant price increases per se would have been all the more reluctant to draw the fire of nationalists by granting rate increases to foreign enterprises. This does not imply, however, that Brazilian-owned utilities fared any better under rate-making policy; as shown in Chapter IV, they have not. Actually, the dominating presence of foreign capital in the Brazilian infrastructure may have

⁵⁴"Brazil suspends profit remittances pending capital registration under new law," loc. cit.; and New York Times, October 28, 1963, p. 41.

encouraged the rate-making authorities to be less considerate of the needs of Brazilian-owned utilities than they would have otherwise been in the absence of that foreign capital.

In addition, utility activities are among the most visible of any foreign investment, and, as well, are among the most important to the host country's economy. One would expect, therefore, that foreign-owned utilities would be especially vulnerable to expressions of hostility engendered by a growing nationalistic environment. In Brazil, this expectation was borne out, not only by the regulatory policy, but also by the multitude of nationalization moves that occurred in 1959 and the early 1960's. These moves will be discussed in the next chapter.

IX. CONCLUSIONS

This chapter has shown that economic development in Brazil has created social dislocations and tensions that had two effects in the area of utility operations. On the one hand, frustrations of Brazilians have encouraged popular opinion to focus on inflation as one of the obstacles to further economic development. As a result, rate-making authorities in the executive branch of the Brazilian Government have been reluctant to irritate the public by granting regulated industries rate increases. In the case of utilities, as pointed out in Chapter IV, the quality of services consequently deteriorated, arousing additional popular

resistance to rate increases. Popular outbursts of feeling such as those described were indicative of that resistance.

On the other hand, frustrations of Brazilians have encouraged popular opinion to focus on foreign influence as another obstacle to further economic development. The growth of nationalism in Brazil has been made evident by such incidents as the passage of the profits remittance law, and, for the foreign-owned utilities, had particular significance. Adequate rate increases for utilities were made all the more unlikely, and the prospect of open expressions of hostility, such as nationalization, was posed. For example, in 1959, the Brazilian Labor Party adopted a platform calling for the nationalization of foreign-owned electric light and power utilities.

In Chapter III, it was pointed out that one of the flaws of the regulatory system for utilities in Brazil was the establishment of regulatory agencies in the executive branch of the Government. The significance of that flaw is now clear. In this arrangement, the regulatory authorities responded to popular demands at the expense of long range planning. In other words, regulation had a tendency to be based on expediency rather than wisdom.

Thus, the Brazilian Government pursued a policy destructive to the health of all electric light and power and telephone utilities in Brazil and destructive to national

economic development, not because of ignorance of the plight of utilities, but because of political expediency.

This expediency can be extrapolated one step further. Utility services became so poor in Brazil that they endangered the economic well-being of the country. National interest required that this problem be corrected, but it could not be corrected through the granting of adequate rate increases. The Brazilian Government was left little choice but to intervene in the utilities and provide the needed services itself. This step is exactly what the nationalists demanded, and, in itself, represented political expediency. As former President Kubitschek stated, the only solution for many of the utilities was for the Government to take them over, and absorb the losses private capital did not want to incur.⁵⁵

⁵⁵Christian Science Monitor, March 8, 1962, p. 7.

CHAPTER VI

BRAZILIAN MOVES TO NATIONALIZE PUBLIC UTILITIES

From the preceding discussions, it is clear that the regulatory system, encouraged by popular demand for cheap prices, created an atmosphere conducive to the deterioration of utility services. The deterioration progressed so as to imperil further economic development in Brazil and arouse popular demands for corrective action. Inevitably, action was finally taken, but that action was primarily motivated by nationalistic feelings.

Since the end of World War II, as mentioned in other chapters, Brazilian Government--at the municipal, state, or national level--has been, increasingly, undertaking public investment in new utility projects. As is evident from Chapter IV, this public investment did not halt the deterioration of utility services, although it may have eased the gravity of the situation to some extent.

Rather than encourage utility investment through correction of the regulatory flaws, Brazil chose to discourage private capital altogether by nationalizing many utilities in order to provide the services itself, at public expense. This chapter describes those moves to nationalize

utilities providing electric light and power and telephone utility services, chiefly foreign-owned utilities. It should be noted that at the time of the writing of this thesis, the nationalization of foreign-owned utilities is far from complete, leaving those remaining under private ownership in a state of limbo, no doubt discouraged about the merits of further investment.

I. EARLY TRENDS TOWARD NATIONALIZATION

In Chapter II, it was noted that, in some instances, the large foreign-owned utilities under consideration here had, at various times, been involved in the provision of utility services other than electric power and telephones. For example, Brazilian Traction, Light and Power Company, Limited (Brazilian Traction) was, and in some cases still is, involved in tramway, water, and gas services. As late as 1959, American & Foreign Power Company Incorporated (AMFORP) supplied municipal transportation and gas in various communities in Brazil.

These types of operations have not been under consideration in this thesis because of the local character of the services and their relative lack of importance in the total operations of these large concerns. Nonetheless, being a part of the companies' Brazilian investments, it is important to note, briefly, the types of experiences the foreign-owned companies had with regulatory authorities.

Tramway, gas, and water services were strictly local in character, and, hence, by and large, under municipal control. As in the case of electric light and power and telephone services, concessions for these other utility operations were required--the terms of the concessions stating the duration of the contract, the disposition of the assets and the amount of compensation in the event of cancellation of the contract by regulatory authorities, and the manner of rate-making for the services.¹

Inadequate rates were also a problem for these services as noted in Chapter V. For example, a privately owned gas company in the City of Sao Paulo cancelled its contract in 1954 because of inadequate rates. A street car company had already taken the same action in the same city. In the same year, two companies supplying water in two different Brazilian cities also cancelled their contracts, for the same reasons. In all cases, provision of the services subsequently fell to municipal authorities, at least for the time being.²

In view of the similarity of circumstances with respect to regulatory rate-making problems of the electric power and telephone utilities, one would expect that there had been

¹Moody's Public Utility Manual 1960 (New York: Moody's Investor Service, Incorporated, 1960), pp. 1375 ff.

²David F. Cavers and James R. Nelson, Electric Power Regulation in Latin America (Baltimore: The Johns Hopkins Press, 1959), p. 43.

similar results. In part, there were. In 1947, Brazilian Traction's tramway system assets in the City of Sao Paulo were transferred to the municipal authorities. In 1952, tramway assets of a Brazilian Traction subsidiary in the City of Santos were turned over to that authority. In 1953, Brazilian Traction's water supply in Santos was transferred to the State of Sao Paulo.³ Finally, in 1960, tramway properties of the same foreign-owned company were turned over to the City of Rio de Janeiro upon expiration of the company's concession in that municipality.⁴

In none of these cases was expropriation reported. Rather, services were turned over to the respective authorities under terms of the concessions. In some instances, these cases appear to correspond to the cancellation of contracts by private companies mentioned above. Nevertheless, the transfer of ownership from private to public hands constituted a form of nationalization--which may have warned the foreign-owned companies of impending trouble, especially in light of the similar circumstances, in the provision of electric power and telephone services. The next chapter will consider the significance of any such warnings.

³Moody's Public Utility Manual 1960, loc. cit.

⁴Moody's Public Utility Manual 1963 (New York: Moody's Investor Service, Incorporated, 1963), pp. 1712 ff.

II. AMERICAN & FOREIGN POWER COMPANY:
1959 CASE IN RIO GRANDE DO SUL

American & Foreign Power Company Incorporated (AMFORP) was the first foreign-owned utility to have one of its Brazilian subsidiaries expropriated. Anticipating the May 5, 1958, expiration of the concession of Companhia Energia Eletrica Rio Grandense--an AMFORP subsidiary that operated electric light and power services in Porto Alegre, the capital of Rio Grande do Sul--the State Governor appointed a commission on September 10, 1957, to determine the value of that company's properties. Under Federal Law, expired concessions were automatically extended pending the granting of a new concession, but the authority granting the concession could call for reversion of the concessionaire's property to the authority upon payment of adequate indemnification to the concessionaire. In this case, the State of Rio Grande do Sul was the basic authority under a Federal Decree concerning the State's electrification program, and the Governor initiated the valuation with the view of acquiring the company's properties for the State power authority, the Comissao Estadual de Energia Eletrica do Rio Grande do Sul. The AMFORP subsidiary cooperated fully in the valuation, but was never permitted to examine the conclusions of the study, which was completed on May 30, 1958.⁵

⁵The Hon. E. Ross Adair, "Expropriation and Foreign Aid Funds," Public Utilities Fortnightly, 69:586-94, April 26, 1962; and United States Department of Commerce, Brazil (Washington: U.S. Government Printing Office, 1961), p. lll.

The valuation made retroactive calculations of the subsidiary's earnings since 1941, and made certain adjustments to earnings, expenses, and capital accounts, most of which AMFORP considered unjustified. The valuation then arrived at an excess earnings figure which was substantially greater than the value the study had placed on the properties, and the commission concluded that no indemnification was required upon reversion of the properties to the State, and that AMFORP should be required to refund the earnings that were in excess of the value of the properties. The AMFORP subsidiary asked for reconsideration, but was refused on May 5, 1959.⁶

In view of the regulatory system that restricted earnings to 10 percent of historical cost, and the decline of utility earnings as a result of this system and an inflationary environment, "excess earnings" were indeed unlikely. As for the refunding of "excess earnings", it seems likely that the commission really did not expect any such refund. Rather, the commission was probably establishing a position from which to negotiate a valuation, with the view of minimizing the amount of compensation paid by the State in event of acquisition of the company's assets.

In March of 1959, Governor Brizola, the new State Governor who had just assumed office, proposed negotiations

⁶The Hon. E. Ross Adair, loc. cit.

with AMFORP, which expressed willingness to enter into such talks. However, on May 8, 1959, the National Council of Waters and Electric Energy stated it to be "convenient and opportune" for the State to acquire the properties of the AMFORP subsidiary, and declared that the State was free to acquire the properties as long as any legally required compensation was paid. With this mandate from the basic Federal regulatory authority, Governor Brizola, on May 12, 1959, issued a decree calling for the acquisition of Companhia Energia Eletrica Rio Grandense properties, and, on the same day, the State power authority filed an expropriation suit with the State Courts, offering to pay one Cruzeiro as the legal indemnification and demanding immediate possession of the properties.⁷

AMFORP sought in the lower courts and obtained a temporary injunction on May 14, 1959, against the State on the grounds that President Kubitschek had not signed the authorization for the expropriation, but the State refused to accept this injunction and return the properties to AMFORP. Efforts to obtain a permanent injunction failed, and AMFORP was unable to regain its properties. The lower courts did require the State to deposit 20 million Cruzeiros, or roughly U.S. \$150,000 at the rate of foreign exchange in effect at the time, as compensation, and appointed an expert

⁷Ibid.

assisted by two advisers, the State and AMFORP naming one each, to determine the value of the properties expropriated. The adviser appointed by the State never took part in the valuation, and on September 30, 1960, the expert filed a report that valued the properties at the time of the expropriation at 2,568,121,600 Cruzeiros, or roughly U.S. \$19.5 million at the free market rate of 132.5 Cruzeiros per Dollar at the time of the expropriation.⁸ AMFORP appealed the case to the Federal Supreme Court, which had not yet decided the issue by 1962.⁹

AMFORP reported its share of investment in the expropriated properties as worth U.S. \$14.1 million, not including the interest of others.¹⁰ It was also reported that at the time of the expropriation the municipality of Porto Alegre owed the power company more than U.S. \$1.5 million,¹¹ presumably for unpaid bills, a not unusual situation.

The underlying issue of this expropriation was the one expected given the public utilities situation in Brazil at

⁸The Hon. E. Ross Adair, loc. cit.; New York Times, May 16, 1959, p. 28; and New York Times, May 18, 1959, p. 41.

⁹The Hon. E. Ross Adair, loc. cit.

¹⁰American & Foreign Power Company Incorporated, Thirty-Sixth Annual Report, 1959 (New York: American & Foreign Power Company Incorporated, 1960), p. 13.

¹¹New York Times, May 13, 1959, p. 7.

the time. Governor Brizola claimed he acted because the "company was not meeting the needs" of the communities it served.¹²

III. OTHER 1959 INCIDENTS IN BRAZIL

At the same time as the Rio Grande do Sul case, another AMFORP subsidiary was faced with a threat of expropriation. In May of 1959, a deputy in the State Legislature of Minas Gerais introduced a bill calling for the expropriation of Companhia Forca e Luz de Minas Gerais. At issue was the severe shortage of power in Belo Horizonte, the State capital, because of drought and failure of the power facilities to keep pace with demand. The State Governor echoed the demands for expropriation, but President Kubitschek intervened and told the AMFORP subsidiary it had sixty days in which to improve the service or it would be expropriated. AMFORP agreed to install ten diesel generators and also arranged to buy power from manufacturers who had independent sources, thus averting expropriation.¹³

The Rio Grande do Sul incident coalesced Brazilian feelings against public utilities, and AMFORP in particular, elsewhere in addition to Minas Gerais. In the State of

¹²New York Times, May 16, 1959, p. 7.

¹³American & Foreign Power Company Incorporated, Thirty-Sixth Annual Report, 1959, op. cit., p. 14; New York Times, May 27, 1959, p. 8; New York Times, June 3, 1959, p. 30; and New York Times, June 5, 1959, p. 34.

Sao Paulo in June of 1959, a bill was introduced into the State Legislature calling for the expropriation of a private Brazilian utility at Votuporanga, with compensation to be based on historical cost. The Federal Ministry of Agriculture set up a committee to evaluate the properties of an AMFORP subsidiary in the State of Pelotas, because the Governor of that State had declared his intentions of expropriating the subsidiary. In the State of Pernambuco, legislative action was initiated against the AMFORP subsidiary supplying electricity, gas, and tramway service in the city of Recife. In connection with the threatened expropriation in Minas Gerais, a student candlelight parade buried the AMFORP subsidiary in effigy.¹⁴

IV. INTERNATIONAL TELEPHONE AND TELEGRAPH CORPORATION: 1962 CASE IN RIO GRANDE DO SUL

After the feelings aroused by the Rio Grande do Sul expropriation in 1959 subsided, there were no further major incidents until Governor Brizola again attracted national and international attention by expropriating telephone properties of an International Telephone and Telegraph Corporation (ITT) subsidiary in the State of Rio Grande do Sul in February of 1962. ITT's telephone operations in Rio Grande do Sul were conducted by its subsidiary, Companhia

¹⁴Herbert Bratter, "Latin American Utilities' Nationalization Proceeds Inexorably," Public Utilities Fortnightly, 66:1-15, July 7, 1960.

Telefonica Nacional (CTN), which also operated telephone service in the state of Parana. In Rio Grande do Sul, operations were conducted under a collection of municipal, state, and federal concessions, some of which had expired but were automatically extended pending execution of new concessions. Because of the problems arising from rate regulation, CTN services had been unable to keep up with the demand for them.¹⁵

In February of 1959, CTN presented the recently elected Governor Brizola with a plan for the expansion and improvement of its services.¹⁶ The details of this plan have not been revealed. In fact, on February 26, 1962, ITT submitted to the State Courts of Rio Grande do Sul a reply to the Court Order of February 16, 1962, that confirmed the expropriation of CTN by the State. This reply alluded to the plan, but did not describe it in any way.¹⁷ It could be claimed that this omission was no more than an oversight. On the other hand, the plan could have contained proposals that might have fueled nationalistic complaints against

¹⁵International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil (New York: International Telephone and Telegraph Corporation, 1962) p. 10.

¹⁶Ibid.

¹⁷International Telephone and Telegraph Corporation, Untitled reply of February 26, 1962, to Court Order of February 16, 1962, confirming Rio Grande do Sul Decree No. 13,186 of February 16, 1962, that expropriated ITT's property in that State.

foreign capital. For example, any proposal calling for an exclusive, State-wide concession for CTN could have evoked charges of exploitation. In addition, any proposal calling for more profits as a prerequisite of improved services might have evoked similar charges. Naturally, any such inferences about the plan are purely speculative, but useful anyway.

Governor Brizola set up a "Work Group" to study the CTN plan without CTN's participation. In January of 1960, the Governor rejected the plan and invited CTN to form a mixed ownership company with the State. The State was to own 10 to 20 percent of the new company's capital, and elect a director to the board. While CTN was reviewing the Governor's proposal, the Governor modified his plan and on June 29, 1960, announced that the State would form a mixed ownership company, to be known as "Companhia Riograndense de Telecomunicacoes", to operate telephone services in the State, and that CTN could participate if it so desired, but that the State would hold 51 percent of the capital and control the board of directors and have technical control. "Companhia Riograndense de Telecomunicacoes" (CRT) was to be given a State-wide concession, a concession which CTN had been consistently denied. CRT was officially created

by State Law No. 4,073 of December 30, 1960.¹⁸

In discussions with the Governor about his proposed company, CRT, CTN protested that it was unable to accept or reject the proposal, because the terms of CTN's participation in the new company were not clear. The amount of the capitalization of the proposed CRT was not known, nor was the value to be assigned to CTN's properties known. A draft of the by-laws was not available, minority rights were not clear, and the proposed composition of the board of directors was not known. The Governor did not make clear what kind of shares and rights CTN was to hold. The Governor did state that the State did not have the financial resources to buy CTN's plant or to expand it in a satisfactory manner.¹⁹

In order to clarify what value CTN properties would have if included in the proposed CRT, CTN and the Governor agreed to an evaluation of CTN by mutually acceptable experts. With this in view, Governor Brizola, in an official dispatch of September 27, 1960, stated to CTN:²⁰

¹⁸International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., pp. 10-13; and International Telephone and Telegraph Corporation, Untitled reply, loc. cit.

¹⁹Ibid.

²⁰International Telephone and Telegraph Corporation, Untitled reply, loc. cit.

. . .The experts shall evaluate the fair present value of the properties effectively used by CTN in the services it furnishes in the State territory

.

It is expressly established that, in the hypothesis of CTN's properties being incorporated to CRT's patrimony, CTN shall not give them, in the subscription of shares of CRT's capital, a value higher than that one fixed in the final report of the present appraisal.

While the Governor was promoting his plan for CRT, ITT claims the State created obstacles in the operation of CTN in order to cause further deterioration of service and mobilize public opinion against CTN and for CRT. The State Communications Commission was alleged to have denied authorization for any investment that CTN was willing to make to improve services. Certain minor projects were permitted only after subscribers made a clamor for the improvements. In addition, foreign experts, some from Communist Bloc nations, were summoned to the State, and CTN was compelled to reveal its communications system to them so that they could design a new system for CRT. Press reports appeared describing the deterioration of CTN services and hinting at impending expropriation.²¹

On March 9, 1961, the experts appointed to appraise CTN properties made their report. As of December 30, 1960, they found that CTN assets were worth 1,302,580,000 Cruzeiros --or roughly \$7.3 million at the then average rate of

²¹Ibid.

exchange, with the figure adjusted for properties not included in the valuation and additions in 1961. The valuation did not include assets in warehouses, cash balances, and accounts receivable, but it did include depreciation in valuing fixed assets.²²

CTN objected to the findings of the experts. It protested to the Governor that the experts had applied indices of costs to the historical value of most of the assets, and thus had determined only "corrected historic cost" and not the "fair present value" called for by the Governor himself in his original proclamation. In addition, the indices chosen by the experts were those determined by the law for the revaluation of assets--Law No. 3,470 of November 28, 1958--and were consequently out of date, not reflecting the current state of affairs. On May 15, 1961, CTN proposed to the State that the same experts should be required to perform a new valuation to determine "fair present value".²³

Governor Brizola, in a proclamation of June 12, 1961, advised CTN that the experts had confirmed their evaluation, and that CTN should accept or reject his proposal for CRT. CTN replied on June 22, 1961, that it could neither accept

²²International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, loc. cit.; and International Telephone and Telegraph Corporation, Untitled reply, loc. cit.

²³Ibid.

nor reject the Governor's proposal, because, besides not agreeing with the valuation placed on CTN, it still did not know the exact terms of its possible participation in CRT.

At the same time, CTN made a number of alternate proposals:²⁴

a) Provision of a franchise for CTN on the basis indicated and with financing to be obtained, with State assistance, from the BNDE [Banco Nacional do Desenvolvimento Economico, the Brazilian economic development bank] or Banco do Brasil or from local sources until such time as outside financing becomes available.

b) Convocation of a competitive public offer for exploitation of the telephone services in the State, under the condition that the winner must acquire the properties of CTN utilized in the exploitation of its services in the State, at a price, to be determined by common accord between the State and CTN. As indicated earlier, to be successful, there would have to be first established a long term franchise recognizing the right of the successful bidder to a fair return on the "present fair value" of his investment.

c) Formation of a mixed economy company to carry out the expansion plan, in collaboration with CTN, and with CTN continuing to operate the joint services and with provision for the liquidation of CTN's property, at a price to be determined in accordance with the principles of "fair present value", over a period of 10 years, or in a shorter period if the mixed company desires, CTN's management and control to terminate upon receipt of final payment and its properties to revert to the mixed company at that time.

d) Sale of the referred properties to the State, at a price to be determined in the manner mentioned . . .above.

e) Organization of a new company, possibly a mixed economy company, which would initially acquire CTN's properties in the frontier zone, and later acquire the rest of CTN's properties in a manner and at a price to be agreed on with the State, based on a reasonable

²⁴International Telephone and Telegraph Corporation, Untitled reply, loc. cit.

plan and within a pre-established period. This would be done on basis that CTN would be permitted a fair return on present fair value and that any acquisition of its property would be on this basis.

When compared to Governor Brizola's position, it is clear CTN advanced propositions that would not have been acceptable to the State. The first proposal required the state-wide concession consistently denied CTN. The second proposal required rate increases and sale of CTN's properties at "fair present value", both of which the State had previously refused. The third proposal required CTN control of the mixed economy company, while the Governor clearly envisioned State control. The fourth proposal, sale of CTN to the State at "fair present value" was unpractical, because the State had already admitted it could not afford the purchase, and had accepted the "corrected historic cost" valuation. The final proposal also required rate increases and acceptance of "fair present value" valuation.

Governor Brizola never replied to the CTN proposals.²⁵

On July 22, 1961, ITT advised the United States Ambassador to Brazil of its "urgent and serious" problem in Rio Grande do Sul, and requested assistance to prevent an expropriation that would go uncompensated for many years while the issues were settled in Brazilian Courts.²⁶ There is no

²⁵International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., p. 11.

²⁶Ibid.

evidence to indicate that assistance was provided, although the United States State Department was clearly aware of the nature of the problem, as evidenced by these statements of Secretary of State Rusk before the 1962 House of Representatives hearings on the Foreign Assistance Act of 1962:²⁷

In this particular situation the State Department had pressed the utility for a long time to expand its services, because the actual extent of telephone service being offered was much less than the growing requirements demanded.

The utility, on the other hand, couldn't make the additional capital investments unless it had assurance of a rate increase that would pay for the investment and keep abreast of the inflation.

The state government was unwilling to give that kind of rate increase. So it got to an impasse.

Governor Brizola, in radio broadcasts on July 28, 1961, declared that he intended to operate CRT in competition with CTN, and that:²⁸

It is expected that equipment from Iron Curtain countries will be obtained and installed. . .the state no longer wants anything to do with the company or the holding company. . .the state is not going to expropriate the American-owned company, nor does it consider it convenient to buy it out with the state holding its obsolete materials.

However, his feelings on expropriation were clarified when in an August conference with law students he declared, "If the United States is really interested in helping Latin

²⁷United States Congress, House of Representatives, Committee on Foreign Affairs, Foreign Assistance Act of 1962, Hearings before Committee, 87th Congress, 2nd Session (Washington: U.S. Government Printing Office, 1962), p. 819.

²⁸The Hon. E. Ross Adair, loc. cit.

Americans, I advise the United States government to help Brazil expropriate and expel foreign companies now exploiting its people."²⁹

In November, the Governor set up a "Special Commission" to re-examine, without CTN's knowledge or participation, the valuation found by experts previously. A portion of CTN's assets represented donated plant or "assets which a few users contributed, over decades, for the installation of telephone lines" (no clearer explanation given).³⁰ The "Special Commission" arbitrarily increased the value of the donated plant and deducted it from the earlier valuation of CTN's assets. A further reduction of 55 percent of the valuation of CTN was made by the Commission on the basis of obsolescence. The Commission made a spot check of two of the oldest of CTN's automatic telephone exchanges and assigned a value of zero to the assets of those offices, even though the original valuation had included depreciation and these two offices were earning revenues and providing services. On the basis of this sample, the Commission deducted from the original valuation a proportion equal to the proportion of junk equipment in the CTN system, thus double counting depreciation. Finally, the "Special Commission" deducted from the original valuation of CTN a large amount to cover

²⁹Ibid.

³⁰International Telephone and Telegraph Corporation, Untitled reply, loc. cit.

the indemnification of CTN employees for loss of jobs in the event of State acquisition of CTN, even though most of the employees would have remained employed in the telephone company. The "Special Commission" then found that CTN was worth only 149,758,000 Cruzeiros, or roughly one-tenth of the original valuation.³¹

On December 22, 1961, Governor Brizola announced that solicitations for CRT subscriptions, the subscriber financing denied CTN, would begin January 2, 1962, with incorporation of the mixed company to operate in competition with CTN to be completed within thirty days. By early February, however, only 27 percent of the subscriptions had been completed, and a new phase of the CTN case began.³²

On the morning of February 16, 1962, Governor Brizola issued Rio Grande do Sul Decree No. 13,186, charging that CTN had proved itself incapable of providing adequate service, that the service was suffocating the State economy, and that CTN equipment was obsolete, and expropriating CTN for purposes of public utility. The complete text of this Decree is given in Appendix A of this thesis.

³¹International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., pp. 11-12; and International Telephone and Telegraph Corporation, Untitled reply, loc. cit.

³²International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, op. cit., p. 12; and The Hon. E. Ross Adair, loc. cit.

At the same time, the State petitioned the State Courts for authorization to possess CTN assets. Within several hours, the Judge of the Public Treasury issued a lengthy opinion upholding the State's action, granting possession to the State, and confirming the amount of the legally required indemnification. ITT reports that the Judge's opinion was obviously prepared in advance, because of the rapidity of its release, and the blanks filled in by hand.³³

The amount of the compensation deposited by the State and affirmed by the Courts was the same as the amount reported by the "Special Commission", 149,758,000 Cruzeiros, or roughly U.S. \$400,000 at exchange rates in effect at the time of the expropriation.³⁴ ITT reported at the time of the expropriation that the properties seized by the State were worth between \$6 million and \$8 million.³⁵

V. REACTION TO THE ITT CASE IN THE UNITED STATES

Governor Brizola's action created an uproar in Brazil and abroad, with far reaching consequences. In the United States, the reaction to the ITT case was generally one of outrage. In contrast, expropriation of AMFORP's properties

³³International Telephone and Telegraph Corporation sources.

³⁴International Telephone and Telegraph Corporation, The Expropriation of ITT in Rio Grande do Sul, Brazil, loc. cit.

³⁵New York Times, February 18, 1962, p. 1.

in 1959 received little notice in the United States, although the value of that property was approximately double that of ITT's. There appear to be two basic reasons for the different reactions to the two Rio Grande do Sul incidents. For one, AMFORP did not attempt to bring its case before the United States public, preferring to settle the issues through quiet negotiations and litigation in Brazil. On the other hand, ITT, perhaps wiser because of the AMFORP experience, elected to force a settlement in Brazil through pressure from the United States. Press coverage of the case was extensive, and ITT mobilized members of the Congress on its behalf. In the House of Representatives, Representative E. Ross Adair read into the Congressional Record³⁶ a summary of the AMFORP and ITT cases in Rio Grande do Sul, much of the information being supplied by ITT and appearing in similar form in ITT's document, The Expropriation of ITT in Rio Grande do Sul, Brazil, which was published later in the same year. In the Senate, Senator Symington read a similar summary into the Congressional Record, along with a letter from the President of ITT describing the case.³⁷ For a second reason, the ITT case attracted more attention because of the recent initiation of the "Alliance for Progress" program for Latin America. This widely heralded program

³⁶Congressional Record, 108: 3393-95, March 5, 1962.

³⁷Congressional Record, 108:4633-34, March 21, 1962.

based its hoped for success on the attraction of significant new private capital to Latin America along with the provision of public funds predicated on broad reforms in Latin American nations. Without new private capital, it was recognized that the program would fail. Governor Brizola's action was regarded as a great discouragement to private capital, and possibly an example of Brazilian ingratitude for the aid being offered. It is significant that ITT's document on its case, The Expropriation of ITT in Rio Grande do Sul, Brazil, used "A Threat to the Alliance for Progress" as its subtitle.

VI. AMENDMENT TO THE FOREIGN ASSISTANCE ACT OF 1962

With the outcry against Governor Brizola's action, there was agitation in the public and the Congress for some firm answer to meet this kind of foreign behavior against United States interests and the threat to foreign aid programs. Legislative action swiftly followed. In late July of 1962, amendments to the 1962 Foreign Assistance Act of the United States--Laws of the 87th Congress, 2nd Session, Public Law 87-565, Section 618 (d)(3)--and the Sugar Act--Laws of the 87th Congress Act, 2nd Session, Public Law 87-535, Section 15--were put into effect. The amendment to the Foreign Assistance Act of 1962, popularly known as the Hickenlooper Amendment, provided that the President shall suspend foreign

aid to any country, the government, governmental agency, or subdivision thereof of which country on or after January 1, 1962, seized, expropriated, or nationalized property or control of property which was not less than 50 percent owned by United States parties. Under the provisions of this amendment, discriminatory taxes or other restrictions on operating conditions that had the effect of seizing, expropriating, or nationalizing property or control of property were to be regarded the same as actual seizure, expropriation, or nationalization. Foreign aid was not to be suspended if within a reasonable period of time--not more than six months after the passage of the Act or the date of the expropriation, whichever was greater--the foreign country took appropriate steps to discharge its obligations under international law, including equitable and speedy compensation for the property in convertible foreign exchange or return of the property or control of the property to its owners. The suspension of foreign aid was to continue until the foreign country took such measures. The amendment to the Sugar Act contained similar provisions for the suspension of benefits to a foreign country, except that the Act applied only to incidents occurring after its passage (July 13, 1962), and not retroactively to January 1, 1962 as in the case of the Foreign Assistance Act.³⁸

³⁸American & Foreign Power Company Incorporated sources; and the New York Times, July 21, 1962, p. 1.

The amendment to the Foreign Assistance Act of 1962 was regarded by some as an ITT engineered device to force Brazil to make speedy and equitable compensation on United States terms for the ITT expropriation in Rio Grande do Sul.³⁹ Other sources described the amendment as being principally of benefit to ITT, and thus special interest legislation.⁴⁰

The amendment had its desired effect in securing compensation. After nearly a year of negotiations involving the State of Rio Grande do Sul, the Federal Government of Brazil, the United States Government, and ITT, an agreement was reached and announced on January 18, 1963, on the eve of the deadline imposed by the amendment to the Foreign Assistance Act of 1962, February 1, 1963. Under the agreement, the Banco do Brasil extended to the ITT industrial subsidiary, Standard Eletrica, S.A., in Brazil a 1,300,000,000 Cruzeiro loan to be used partly for industrial expansion in Brazil, with the remainder, approximately one-half, to be repatriated to ITT in the United States. The loan, worth roughly \$7.3 million at the exchange rate applicable at the time, was to be repaid by ITT when the Brazilian Courts finally decided on ITT's claims against the State of Rio Grande do Sul, ITT applying the proceeds of any award to the repayment of the loan. The agreement included a

³⁹"International Telephone and Telegraph", Forbes, 93: 20-4, February 1, 1962.

⁴⁰New York Times, July 21, 1962, p. 1.

complicated formula for compensating ITT for depreciation of the Cruzeiro while the Courts decided on a valuation for the Rio Grande do Sul properties. The loan agreement was accomplished through a "swap" arrangement whereby ITT in effect made Dollar loans to the Banco do Brasil in return for Cruzeiros for its industrial subsidiary. ITT promised, in the agreement, to give ample publicity to the settlement in order to undo some of the bad impressions it had created about Brazil in its campaign in the United States to secure compensation.⁴¹

VII. REACTION OF THE FEDERAL GOVERNMENT OF BRAZIL TO THE CASE

In Brazil, Governor Brizola's expropriation of ITT telephone properties in Rio Grande do Sul brought the utility situation to a crisis, and touched off a new series of expropriation attempts by other states. The expropriation itself created renewed political interest in public utilities and political agitation for more takeovers, as did the 1959 Rio Grande do Sul expropriation. The negotiations following the expropriation created a situation that made expropriations by other states even more attractive.

⁴¹"Brazil Patches up ITT Expropriation on Eve of Plea for Renewed Aid from U.S." Business Week, February 2, 1963, p. 87; "IT&T's Interim Agreement on Expropriated Porto Alegre Property Called Satisfactory," International Commerce, 69:17, February 11, 1963; and New York Times (Western Edition), January 19, 1963, p. 1.

The United States reaction to the expropriation had an important bearing on Brazil's relations with the United States, primarily in the area of continued foreign aid on which the Federal Government of Brazil heavily depended. Speedy settlement of the case was a prerequisite to continued good relations with the United States, yet, at the same time, Governor Brizola refused to conduct direct negotiations with ITT for a settlement of the case. Shortly after the expropriation, on February 26, 1962, Governor Brizola said, "I do not consider them suited for negotiations because the problem is now in the courts, and it is not for us to act outside the courts."⁴² The impasse between the Governor and ITT did nothing to abate the criticism emanating from the United States, and the Federal Government of Brazil was forced to take an active part in bringing about a settlement.

In the initial stages of the negotiations, the Federal Government of Brazil refused to assume any responsibility for the case, arguing that to accept such responsibility would be an interference by the Federal Government in the jurisdiction of a state. Instead, the Federal Government attempted to limit its role to that of providing only its "good offices" in the negotiations.⁴³ However, ITT and the United States Government continued to press the Federal

⁴²New York Times, February 27, 1962, p. 14.

⁴³New York Times, March 4, 1962, p. 38.

Government of Brazil for acceptance of responsibility, and as time passed without any sign of a settlement between the State of Rio Grande do Sul and ITT, it became more apparent that the Federal Government of Brazil would have to become more involved.⁴⁴ During March of 1962, President Goulart hinted that negotiations were required to settle the general utility problems in Brazil, and that he believed that ownership of the foreign owned utilities should be transferred to Brazilian hands.⁴⁵ On April 12, 1962 it was prematurely reported that a settlement had been reached whereby the Federal Government of Brazil would make the loan to ITT that was eventually agreed upon in the final settlement. The premature report was released by Brazilian and United States officials before final details had been worked out, but the report indicated the nature of the eventual settlement reached in January of 1963, and the final acceptance by the Brazilian Government of its responsibility in the case.⁴⁶ For the purposes here, it is very important to keep track of the dates of these developments in negotiations, and it must be kept in mind that during March of 1962, it was only becoming increasingly apparent that the Federal Government was eventually going to assume responsibility

⁴⁴Ibid.

⁴⁵New York Times, March 25, 1962, p. 10.

⁴⁶New York Times, April 13, 1962, p. 1.

and pay for the ITT properties, although it had not done so yet.

At the same time, there were other indications that the Federal Government was eventually going to assume responsibility for the public utility problems as a whole, not merely in the ITT case. For instance, in November of 1961, just prior to the ITT expropriation in Rio Grande do Sul, AMFORP initiated discussions with the Federal Government of Brazil for the sale of its entire utility holdings in Brazil.⁴⁷ That such discussions were going on at this time meant that the Federal Government of Brazil was considering the enlargement of its activities in public utility ownership. In addition, in April, 1961, the Federal Government reorganized its electric power activities through the creation of a Government controlled company, Empresa Centrais Eletricas Brasileiras, S.A. (ELETROBRAS), established by Law No. 3,890-A. This company centralized Federal Government power to formulate electric power programs and to construct, own, and operate electric power facilities.⁴⁸ The establishment of ELETROBRAS alone did not indicate that the Federal Government was going to increase its activities in the electric power utilities, but in reference to other developments one might conclude that the Government was contemplating increased

⁴⁷American & Foreign Power Company Incorporated sources.

⁴⁸United States Department of Commerce, op. cit., p. 109.

activity. In early 1962, the Brazilian Congress was considering the establishment of a similar authority for national telecommunications utilities, a company to be known as TELEBRAS. In mid 1962, TELEBRAS was officially created.⁴⁹

Another strong and important indication that the Federal Government of Brazil was contemplating active intervention in the telephone utilities, and possibly in the ITT case in particular, came on March 2, 1962, through the issuance of Federal Decree No. 640, attached as Appendix B of this thesis. This decree noted the inadequacies of telephone service in the country and declared that telecommunications were a basic industry vital to the national economy and security. It further declared that the national economic development bank, Banco Nacional Desenvolvimento Economico (BNDE), was authorized, as a priority operation, to promote the development of telecommunications and to acquire shares of telecommunication companies. The Decree explicitly had in view the establishment of TELEBRAS and its operations in the promotion of national telecommunications facilities.

VIII. REACTION OF BRAZILIAN STATES TO THE CASE AND THE POSITION OF THE FEDERAL GOVERNMENT

These moves--although in March of 1962 they were still

⁴⁹Fundacao Getulio Vargas, Instituto Brasileiro de Economia, Conjuntura Economica, International Edition, Rio de Janeiro, Year X, No. 2 (February, 1963) pp. 123-37.

inconclusive--indicated that the policy of the Brazilian Federal Government seemed to be shifting toward greater participation in telephone and electric light and power utilities. As in the case of the 1959 expropriation in Rio Grande do Sul, the ITT incident created renewed interest in other states for further expropriations. The prospect of Federal intervention in the settlement of the ITT case and telecommunications problems in general had a profound effect on that renewed interest. First, if the Federal Government was going to pay for the ITT properties expropriated by Rio Grande do Sul, then the Federal Government might pay for properties expropriated by other states. This would remove the Constitutional requirement that the expropriating agency pay adequate indemnification. That is, the states could expropriate properties and let the Federal Government worry about the compensation requirement. Second, if the Federal Government was preparing to nationalize utilities, then the states might beat it to the punch by expropriating utilities first and taking political credit. That is, if nationalization of utilities was imminent, then local politicians could take the credit if they acted before the Federal Government did. These two lines of reasoning led some state governors to the conclusion that it was a propitious time to expropriate utilities, especially in view of nationalistic demands for such action.

In addition, there were other considerations that increased the likelihood of state expropriations. First, according to some sources, government control and ownership of utilities created numerous opportunities for political patronage appointments.⁵⁰ By expropriating utilities before the Federal Government could nationalize them, local politicians could reserve those opportunities to themselves. Second, if, in addition, a state governor were hostile to the Federal Government, as in one case to be mentioned shortly, and wanted to create an embarrassing situation for the Federal Government at a time when it appeared that the Federal Government was going to commit itself to payment for state expropriations, then state expropriation before the Federal Government could act would have created such a situation.

With these in view, Governor Carlos Lacerda of the State of Guanabara announced on March 3, 1962, that if the Federal Government of Brazil paid compensation for the Rio Grande do Sul expropriation of ITT, he would seize the telephone subsidiary of Brazilian Traction, Light and Power Company, Limited (Brazilian Traction) in Rio de Janeiro, where 300,000 persons were reported to be waiting for telephones.⁵¹ In Chapter II, it was pointed out that Brazilian Traction owned

⁵⁰International Telephone and Telegraph Corporation sources.

⁵¹New York Times, March 4, 1962, p. 38.

roughly 80 percent of the total telephones in service in Brazil in 1958. A substantial portion of these telephones were in Rio de Janeiro. Governor Lacerda carried out his threat at the end of March, an event that will be discussed shortly.

On March 24, 1962, a bill was presented in the City Council of Santos in the state of Sao Paulo for the expropriation of the Santos telephone subsidiary of Brazilian Traction. The bill was introduced in protest of a requirement that new subscribers purchase debentures for the installation of their own phones, a form of financing that ITT had proposed in Rio Grande do Sul.⁵²

IX. FEDERAL EFFORTS TO BLOCK FURTHER STATE ACTIONS

Anticipating the possibility of further expropriation attempts against telephone utilities, and the difficulties those attempts would have created for the Federal Government with respect to international relations and the need for Federal intervention in the cases, the Federal Government on March 27, 1962, issued Decree No. 790 forbidding any expropriation that would have affected properties involved in interstate telephone service, unless prior approval had been granted by the National Security Council and the Federal

⁵²New York Times, March 25, 1962, p. 10.

Minister of Transport and Public Works. Properties involved in interstate telephone service were defined as those of a concessionary company which operated in more than one state, and for the purposes of expropriation, those properties belonging to a single company could not be separated. The Decree also established provisions for a special toll fee on interstate service to be used for expansion of telephone facilities. The disposition of the funds so collected was to be left to the Minister of Transport and Public Works. The complete text of Decree No. 790 is given in Appendix C of this thesis.

X. CASE OF BRAZILIAN TRACTION, LIGHT AND POWER COMPANY IN GUANABARA, AND OTHERS

On March 29, 1962, Governor Brizola in the State of Rio Grande do Sul announced his plans for another expropriation in that State. He stated that as soon as legal formalities could be completed, he would expropriate the Rio Grandense Light and Power Syndicate, Limited, serving the City of Pelotas with electric light and power services.⁵³ This company was owned primarily by AMFORP, although British interests have been reported as co-shareholders,⁵⁴ and was valued at roughly \$5 million.⁵⁵ State authorities declared

⁵³New York Times, March 30, 1962, p. 45.

⁵⁴Werner Haas, Foreign Investments in Brazil (Sao Paulo: Werner Haas, 1960), no page number.

⁵⁵New York Times, March 30, 1962, p. 45.

that they were waiting only for an advisory opinion from the National Council of Waters and Electric Energy before presenting the case to the State Courts.⁵⁶

On March 30, 1962, Governor Carlos Lacerda of Guanabara State announced that he was expropriating the properties of Companhia Telefonica Brasileira (CTB), a subsidiary of Brazilian Traction, providing telephone services in the City of Rio de Janeiro. Declaring the expropriation to be essential to the public welfare, the Governor stated that he was going to ask the State Courts to appoint an intervener to take over the properties of CTB in the City of Rio de Janeiro. For compensation, the Governor declared his intentions of giving foreign shareholders debentures with a guaranteed annual interest of 12 percent. Brazilian Traction reported that the expropriation move had come as a "complete surprise", because they had been negotiating the transfer of their telephone utility to Brazilian hands with the Federal Government of Brazil.⁵⁷

Besides serving Rio de Janeiro, CTB provided telephone service in the City of Sao Paulo and surrounding areas in the State of Sao Paulo, its total operations providing about 800,000 installed telephones, or roughly 80 percent of the telephones in Brazil.⁵⁸ According to 1962 figures, there

⁵⁶Ibid.

⁵⁷New York Times, March 31, 1962, p. 3; and New York Times, April 1, 1962, p. 36.

⁵⁸Ibid.

were approximately 344,000 telephones in service in Rio de Janeiro that year, representing roughly 33 percent of the nation's total.⁵⁹ Most, if not all of these, were provided by CTB. At the time of the expropriation attempt, the book value of the properties involved was reported as \$60 million at the current official rate of exchange.⁶⁰

The underlying issue, as in the other cases, was the quality of the service offered by CTB. For all of CTB's area of operation, at the time of the expropriation it was reported that there was a backlog of some 500,000 applications for service. Governor Lacerda charged that in the City of Rio de Janeiro, there was a waiting list of 200,000 persons, some of whom had been waiting for ten years, which was probable in view of the situation described in Chapter IV. He said the State would charge that CTB had failed to meet its obligations called for in the concession contract, which provided for the cancellation of the concession if the concessionaire failed to fulfill its requirements. Brazilian Traction replied that it had been unable to expand its services because the rate structure for their services did not allow a sufficient return to capital, thus

⁵⁹American Telephone and Telegraph Company, The World's Telephones 1962 (New York: American Telephone and Telegraph Company, 1962), pp. 4 & 12.

⁶⁰New York Times, April 1, 1962, p. 36.

preventing infusion of new investment.⁶¹

At the time of the expropriation incident, it was reported that Governor Lacerda had been under heavy political pressure for action on the telephone problem in the City of Rio de Janeiro, especially from nationalist groups. Besides satisfying those demands, he had other reasons for his action. For one, he had anticipated impending Federal action on CTB and telephone utilities in general. For another, he had sensed that the Federal Government was going to commit itself to paying for the Rio Grande do Sul expropriation of ITT properties.⁶² As mentioned previously, these expectations enhanced the attractiveness of an expropriation move, for the Governor could take the credit without worrying about the cost to the State treasury. Other observers have suggested that, in addition, Governor Lacerda, being hostile to the administration of President Goulart, wished to embarrass it.⁶³ By way of justification, the Governor stated that he did not believe that Alliance for Progress funds coming into the hands of the Federal Government of Brazil should be used to buy out foreign owners of utility enterprises when there was a greater need for new public

⁶¹New York Times, April 1, 1962, p. 36; and New York Times, March 31, 1962, p. 3.

⁶²Ibid.

⁶³International Telephone and Telegraph Corporation sources.

investment in public schools and the like. He also noted that Federal Decree No. 640 of March 2, 1962, authorized the Banco Nacional do Desenvolvimento Economico to buy stock of telephone utilities, and that the Bank was the chief channel of foreign aid assistance funds. Finally, Governor Lacerda in his expropriation declaration stated that his move was different than that of Governor Brizola in the ITT case in Rio Grande do Sul, because he intended to improve the service.⁶⁴

XI. SIGNIFICANCE OF STATE ACTIONS

The expropriation attempt by Governor Lacerda shed light on some of the underlying issues of the Brazilian public utility situation. Governor Brizola, who attracted so much attention with his expropriations in Rio Grande do Sul, was known to be an ardent nationalist and "leftwing" politician. Statements of his cited in previous chapters revealed his desires to expel foreign interests from Brazil. His expropriations, when viewed in this light, were not surprising, being entirely consistent with his political views. It was sometimes argued, indeed, that the incidents in Rio Grande do Sul did not reflect a general trend but an isolated case of hostility toward foreign-owned utilities. President Kennedy, in a press conference in early March of

⁶⁴New York Times, March 31, 1962, p. 3; and New York Times, April 1, 1962, p. 36.

1962, said of the proposed amendments to the Foreign Assistance Act of 1962, "I can think of nothing more unwise than to attempt to pass a resolution at this time which puts us in a position not of disagreement with a governor of a state who is not particularly our friend, but instead, really, with the whole Brazilian nation. . . ." ⁶⁵ Removed from its broader context with respect to the Foreign Assistance Act of 1962, the President's statement appears to contain the belief that the ITT case, about which he was indirectly speaking, was an isolated incident and not part of a general trend.

Governor Lacerda's expropriation attempt against CTB countered such opinions. Governor Lacerda was not an ardent nationalist in the Governor Brizola fashion, and he was regarded as a "right-wing" politician and outspoken anti-communist. The Governor's chief preoccupation politically was not the expulsion of foreign interests, but solving Brazil's problems through administrative reforms. ⁶⁶ His action against CTB reflected neither hostility toward foreign capital, particularly utilities, nor accommodation with his political views as much as it reflected political acceptance of popular demands and political capitalization on a unique

⁶⁵New York Times, March 8, 1962, p. 14.

⁶⁶"Front-Runner and Giant Killer," Business Week, April 11, 1964, p. 76; New York Times, August 27, 1962, p. 5; and New York Times, August 28, 1962, p. 11.

opportunity presented by the Federal Government of Brazil.

Other expropriation attempts outside of Rio Grande do Sul, such as those already mentioned or those yet to come, also served to dispel the notion that Governor Brizola's actions represented isolated incidents. For example, shortly after Governor Lacerda set his example, Governor Magalhães Pinto of the State of Minas Gerais announced his intentions of expropriating telephone and power subsidiaries of Brazilian Traction in his State.⁶⁷

XII. FEDERAL GOVERNMENT BLOCKS STATE ACTIONS

The Federal Government was unable to tolerate expropriation moves such as these. First, friendly foreign relations with important aid suppliers such as the United States were imperiled as the foreign investors clamored for protection and retribution. Second, the Federal Government would have been forced to pay for the expropriations in order to preserve friendly foreign relations, because the states could not or would not pay. Even for the Federal Government, payment for utility investments in excess of one billion dollars would have been a tremendous burden. Third, the Federal Government had decreed with Decree No. 790 of March 27, 1962, that Federal permission was required for further telephone utility expropriations, but Governor

⁶⁷"What Should U.S. Aid Do in Latin America?," Business Week, April 7, 1962, pp. 32-33.

Lacerda's action made it clear that some state governors were going to disregard this Decree. If the Federal Government failed to stand behind this Decree, then it would become meaningless in other cases as well. Finally, fragmentation of telephone utility operations through numerous expropriations had prospects of further deteriorating the service.

The response of the Federal Government of Brazil to the expropriation attempt of Governor Lacerda on March 30, 1962, came on the following day with the issuance of Decree No. 814 of March 31, 1962. Invoking Governor Lacerda's failure to comply with Decree No. 790 of March 27, 1962, which required Federal permission for the expropriation of properties involved in interstate telephone service, Decree No. 814 declared Federal intervention in CTB for the purposes of preventing Governor Lacerda's dismemberment of an interstate concessionaire company.⁶⁸ This intervention thwarted the Governor's expropriation attempt, and brought CTB under Federal control without actual Federal expropriation. At last reports, Federal intervention in CTB continued.⁶⁹

Federal intervention in CTB came in the form of military

⁶⁸New York Times, April 1, 1962, p. 36; see also Federal Decree No. 881 of April 11, 1962, in Appendix D of this thesis.

⁶⁹"Hot Line", Newsweek, 62:79, October 21, 1963.

supervision of the Company's operations.⁷⁰ Actually, a general was assigned to sit in the Company's offices while CTB went about its normal affairs,⁷¹ thus establishing "Federal intervention" without actual involvement in daily operations.

The power of intervention in telephone utilities was extended through Federal Decree No. 881 of April 11, 1962. This Decree established the legal basis (interstate communications) for Federal intervention in telephone utility lawsuits as a precautionary measure against further state expropriation attempts, and extended to the intervener appointed to CTB the powers to intervene in any subsidiaries of CTB or any other telephone concession companies involved in interstate telephone service and threatened with expropriation proceedings that did not comply with Decree No. 790 of March 27, 1962. Decree No. 881 of April 11, 1962, is attached in Appendix D of this thesis.

XIII. GOULART PLAN FOR NATIONALIZATION OF UTILITIES

At the same time the Federal Government decreed its intervention in CTB, reports of a new plan for foreign utility investors began to circulate. It was mentioned earlier in this Chapter that President Goulart had hinted about a negotiated transfer of foreign-owned utilities to Brazilian

⁷⁰Ibid.

⁷¹International Telephone and Telegraph Corporation sources.

hands during March of 1962. Early in April, President Goulart was scheduled to visit the United States and confer with President Kennedy. Prior to his trip, reports appeared stating that the two Presidents were to discuss a plan under which foreign investors in utilities would switch to other investments in less sensitive enterprises. According to the alleged plan, the Federal Government of Brazil would give the utility owners a down payment for their investments, would assume ownership of the utility enterprises, and would pay the balance to the former owners out of rate increases that were expected to follow the transfer of ownership to Government hands. In return for this settlement, the utility owners were to invest their funds retrieved from the utilities into other Brazilian enterprises.⁷²

During his trip to the United States in the first week of April, 1962, President Goulart, by his own admission at a news conference at the time, conferred at great length with President Kennedy on the problem of foreign-owned utilities in Brazil. The joint communique the two Presidents issued on April 4, 1962, stated with respect to the utilities problem:⁷³

The President of Brazil stated the intention of his Government to maintain conditions of security which will permit private capital to perform its vital

⁷²New York Times, April 1, 1962, p. 36.

⁷³New York Times, April 5, 1962, pp. 1 & 3.

role in Brazilian economic development. The President of Brazil stated that in arrangements with the companies for the transfer of public utility enterprises to Brazilian ownership the principle of fair compensation with reinvestment in other sectors important to Brazilian economic development would be maintained. President Kennedy expressed great interest in this approach.

This statement has been widely interpreted as meaning that the United States Government concurred in the Goulart plan, because the plan would presumably eliminate a serious source of friction between the United States and Brazil. The utilities themselves, as will be seen shortly, were instrumental in the formulation of the plan, and were in favor of it.⁷⁴

At a press conference at the United Nations in New York on April 6, President Goulart stated that under his plan, utility expropriations would be speeded with fair compensation being paid for the properties. The President noted that governmental reluctance to grant rate increases had caused the utility services to deteriorate, and that the resulting situation had caused the utilities to become "friction centers" between Brazil and the countries in which the owners of the utilities resided.⁷⁵

On May 23, 1962, it was reported that the Brazilian Council of Ministers had formalized and approved a decree implementing the Goulart Plan, or "Global Plan" as it is

⁷⁴Ibid.

⁷⁵New York Times, April 7, 1962, p. 2.

sometimes called, for the nationalization of Brazilian public utilities.⁷⁶ The Decree--Decree No. 1,106 of May 30, 1962-- was published and put into effect a week later. Shortly thereafter, another Decree--Decree No. 1, 164 of June 8, 1962 --amended the previous Decree slightly with respect to organization of the committee to carry out the nationalization program. Both decrees are attached in Appendixes E and F respectively in this thesis.

The Goulart Plan, as embodied by these two decrees, established a committee of five members under the authority of the President of the Council of Ministers. The committee was charged with submitting to the approval of the Council of Ministers a list of the utilities that should be nationalized and the order of priority; with negotiating with the utility companies on the conditions of indemnification, subject to the approval of the Council of Ministers; and with fixing the standards of valuation of the companies, in accordance with existing legislation. The conditions for indemnification were required to conform with certain principles: (1), a down payment was to be made not greater than 10 percent of the valuation agreed upon; (2), the deferred portion of the indemnification was to be made in installments "compatible, whenever possible, with the funds generated by the service itself and a minimum of additional public

⁷⁶New York Times, May 24, 1962, p. 17.

funds"; (3), the plan for indemnification was to require a minimum of foreign exchange; and (4), the concessionaires were to reinvest in Brazil in fields designated by the National Planning Commission, and not in existing enterprises, at least 75 percent of the amount of indemnification. In event of disagreement over the valuation, the Goulart Plan made provisions for arbitration by three arbiters--one a representative of the Government, one a representative of the concessionaire, and the third a mutually agreed upon expert. In event the other two parties could not agree upon the latter, he would be appointed by the President of the Council of Ministers, with Cabinet approval.

Attached in Appendix G of this thesis is a translation of Decree No. 1,203 of June 19, 1962, which established internal working regulations for the commission.

XIV. ATTITUDES OF FOREIGNERS TOWARD PLAN

Announcement of the Goulart Plan stirred some valid controversy over the meaning of the decrees. An article in the New York Times suggested:⁷⁷

If there were no profits there would be no further compensation. Obviously, it would be advantageous--that is, it would be "profitable"--for the expropriating nation to see to it that the seized foreign business was run thereafter as a "nonprofit enterprise."

⁷⁷New York Times, June 10, 1962, Section III, p. 1.

This passage moved the Brazilian Ambassador to the United States to reply in a letter to the New York Times:⁷⁸

Neither in the decree nor in the discussions which led up to it has it ever been suggested that the payment of compensation would be dependent upon the profits of the nationalized enterprise, and I can assure that this not the intent of the Brazilian Government.

Any suggestion or inference that my Government would deliberately see to it that there were no profits as a device for evading payment of fair compensation for a public utility enterprise it acquires is a gratuitous and unjustified reflection upon the integrity and good faith of Brazil.

The letter of Ambassador Campos evoked a rebuttal from another commentator, who pointed out that the text of the decree contained "weasel words": "compatible, whenever possible, with the funds generated by the service itself and a minimum of additional public funds." In the view of the commentator, the words of the decree were binding, not the Ambassador's assurances.⁷⁹

Distrust in the Goulart Plan and its intentions could have been lessened if the wording of the Decree had been less ambiguous, for the interpretations cited were plausible ones. A turn in Brazilian policy toward more nationalistic extremes could have resulted in the "weasel word" interpretation by popularly elected leaders. In addition, given that

⁷⁸New York Times, June 19, 1962, p. 34.

⁷⁹Virgil Salera, "Variations on a Theme of Expropriation," Inter-American Economic Affairs, Volume 16, No. 3, Winter 1962.

the Plan represented the direction of Brazilian policy, distrust in the Plan could have been lessened by immediate implementation of it on a small scale in the manner visualized by Ambassador Campos. The example set thereby would have demonstrated Brazil's good faith. Finally, speedy settlements of the unresolved litigation arising from the two expropriations in Rio Grande do Sul--AMFORP's subsidiary in 1959 and ITT's subsidiary in 1962--would have helped to allay foreign fears.

Actually, in spite of the misgivings of some, the Goulart Plan was a welcomed step to the utilities, for the basis of the Plan, but probably not its wording, came from the initiative of foreign-owned utilities. It was mentioned previously that AMFORP had initiated negotiations with the Federal Government of Brazil in November of 1961 for the sale of its Brazilian utility holdings. In the proposals submitted to the Federal Government of Brazil at the time, AMFORP listed a series of arguments favoring Government ownership of electric power utilities and AMFORP subsidiaries in particular, and advanced acceptable terms for the sale of its holding. AMFORP asked for U.S. \$153,788,000 for its securities, that figure representing actual cash costs and the capitalized portion of its retained earnings. For minority shareholders, AMFORP asked for the equivalent of U.S. \$29,271,530, based upon the prevailing rates of exchange

at the time minority shares were sold and the portion of capitalized retained earnings accruing to those shares. The Federal Government of Brazil was to assume responsibility for outstanding debts and liabilities, as of December 31, 1960, amounting to roughly U.S. \$40,200,000 due to the Export-Import Bank and 445,939,000 Cruzeiros due to the Banco Nacional do Desenvolvimento Economico and other miscellaneous amounts. AMFORP asked for a reasonable down payment with the balance to be paid over a fifteen year period with appropriate interest. The utility holding company agreed to reinvest a major portion of the deferred payments, exclusive of interest, in other non-utility enterprises in Brazil. AMFORP stipulated that all payments connected with its proposal were to be free of Brazilian taxes, and that the Federal Government of Brazil was to assume responsibility for all of the contracts of its subsidiaries and legal obligations to all employees other than top managerial personnel.⁸⁰

The Goulart Plan clearly embodied the key elements of the AMFORP proposal, principally the method of indemnification.

AMFORP was not the only utility anxious to withdraw from the situation in Brazil. It was mentioned previously that

⁸⁰American & Foreign Power Company Incorporated sources.

ITT had proposed the sale of its telephone operations in the State of Rio Grande do Sul, and had negotiated the proposal with Governor Brizola prior to his expropriation of those properties. Brazilian Traction had been negotiating with the Federal Government of Brazil for the sale of its telephone utility operations when Governor Carlos Lacerda of Guanabara State attempted to expropriate a portion of those operations in the City of Rio de Janeiro in March of 1962.⁸¹

From the time AMFORP submitted its initial proposal to the announcement of the Goulart Plan, preliminary discussions were held with the Federal Government of Brazil. In July of 1962, AMFORP submitted a memorandum of the salient points agreed upon up to that date, and on August 29, 1962, the committee created by the Goulart Plan issued Portaria No. 1, which created a sub-committee to undertake a valuation of AMFORP's Brazilian properties according to: (1), unadjusted historical cost; (2), historical cost adjusted by indices supplied by the National Economic Council pursuant to Article 57 of the 1958 Law for the revaluation of assets, Law 3,470; (3), historical cost adjusted by indices of the Getulio Vargas Foundation; and (4), cost of reproduction.⁸² A translation of Portaria No. 1 of the Committee of August 29, 1962, is attached in Appendix H of this thesis.

⁸¹New York Times, March 31, 1962, p. 3.

⁸²American & Foreign Power Company Incorporated sources.

XV. ADDITIONAL STATE ACTIONS DURING
FORMULATION OF THE GOULART PLAN

During the time the Goulart Plan was being formulated and implemented, there were a few other expropriation incidents created by Brazilian states. On May 6, 1962, Governor Braga of Parana State announced that expropriation of ITT telephone properties, valued at roughly nine million dollars, was "under consideration", but that such action would only be carried out "if all efforts to solve our phone problem fail".⁸³ The threat, however, was never carried out.⁸⁴

In July of 1962, the Governor of the State of Espirito Santo expropriated properties of Companhia Central Brasileira de Forca Eletrica, an AMFORP subsidiary serving the City of Vitoria. AMFORP brought suit against the State for recovery of the properties on the grounds that the State did not have the prior approval of the National Council of Waters and Electric Energy. The Federal Government intervened on AMFORP's behalf, and the case went to the Brazilian Supreme Court, which returned the properties to AMFORP on April 30, 1963.⁸⁵

The final case of a state takeover of a foreign-owned

⁸³New York Times, May 7, 1962, p. 49.

⁸⁴International Telephone and Telegraph Corporation sources.

⁸⁵New York Times, May 1, 1963, p. 57; and American & Foreign Power Company Incorporated sources.

utility was one which was not generally termed an expropriation, although the parallel exists. During 1961, the State of Pernambuco notified the Pernambuco Tramways and Power Company, Limited (a subsidiary of AMFORP in which AMFORP reported it had an investment of approximately \$14 million) that its concession contract would not be renewed when it expired on July 17, 1962, and that the electric service properties would be taken over by the State. AMFORP, anticipating the loss of its properties, brought suit against the Federal Government and the State of Pernambuco in order to obtain compensation for its assets.⁸⁶

The issues were similar to those in other cases. Miguel Arraes de Alencar, the allegedly leftist Mayor of the City of Recife, in which the AMFORP subsidiary operated, stated in May of 1962 that the AMFORP subsidiary had failed to keep its contract for the provision of street lighting for the City, forcing the City to install lighting in nearly two thousand streets itself. Noting public resentment against the delays in the installation of lights, the Mayor said, "People reason in local terms. Suppose a Brazilian company operating in the United States had failed to provide street lights. Don't you think people would react?" The AMFORP subsidiary had insisted that it could not make the investment

⁸⁶ American & Foreign Power Company Incorporated, Thirty-Eighth Annual Report, 1961 (New York: American & Foreign Power Company Incorporated, 1962), p. 14.

without adequate rate increases.⁸⁷ The subsidiary also asserted that the City owed the company \$125,000 for its light bill.⁸⁸

On July 17, 1962, when the AMFORP subsidiary's concession expired, the Governor of the State of Pernambuco ordered the subsidiary to turn its utility properties over to the State. The subsidiary asked the State Courts for an injunction against the State order.⁸⁹ The State Courts appointed a receiver to operate the company pending resolution of the litigation.⁹⁰

According to the Brazilian Embassy in Washington, this case was not an expropriation. It said that the terms of the concession called for reversion of the properties to the State when the concession expired, and that the company had been indemnified by a special user's tax that had been paid over the years.⁹¹ This disagreement over the reversion apparently centered around compensation, for a spokesman for the concession said the company should not be deprived of its property without compensation.⁹²

⁸⁷New York Times, May 19, 1962, p. 9.

⁸⁸New York Times, July 16, 1962, p. 33.

⁸⁹New York Times, July 17, 1962, p. 11.

⁹⁰American & Foreign Power Company Incorporated, Thirty-Ninth Annual Report, 1962 (New York: American & Foreign Power Company Incorporated, 1963), p. 9.

⁹¹New York Times, July 17, 1962, p. 11.

⁹²Ibid.

XVI. PRELIMINARY AGREEMENTS UNDER THE GOULART PLAN

The most recent phase of the Brazilian moves to nationalize the foreign-owned utilities began when AMFORP and the Federal Government of Brazil signed a memorandum of understanding for the sale of AMFORP's Brazilian properties to the Government on April 22, 1963. The agreement, negotiated with the committee established under the Goulart Plan, conformed to the guide lines of the Plan. The agreement called for a contract to be entered into for the purchase by the Government or one of its agencies of the AMFORP properties for a price of U.S. \$135 million. Of this amount, AMFORP was to receive a down payment of \$10 million in New York at the time of the signing of the contract, but no later than July 1, 1963. The balance of the indemnification was to be payable in the United States in U.S. Dollar notes to be guaranteed by or issued by the Federal Government of Brazil and maturing semiannually beginning in 1966 over a twenty-two year period. AMFORP agreed that 75 percent of the total purchase price was to be reinvested in non-utility enterprises in Brazil. An interest rate of $6\frac{1}{2}$ percent per annum was to apply to the portion of the notes to be reinvested, and a rate of 6 percent per annum was to apply to the balance. In addition to the purchase price, AMFORP was to receive \$7.7 million for all dividends, interest, and other items currently owed the company by its subsidiaries as of

December 31, 1962, of which amount 10 percent was to be paid in cash in New York with the signing of the contract and the balance was to be payable in U.S. Dollar notes earning 6 percent annually and maturing over a fifteen year period beginning in 1963. The Brazilian Government was to take over the personnel of the subsidiaries except for top managerial employees and assume responsibility for all debts of the AMFORP subsidiaries, principally debt payable to the Export-Import Bank. The agreement included the purchase of AMFORP's subsidiaries in Porto Alegre, Vitoria, and Recife in the States of Rio Grande do Sul, Espirito Santo, and Pernambuco respectively--subsidiaries which had previously been expropriated or otherwise removed from AMFORP's control.⁹³

At the same time the AMFORP memorandum of understanding was entered into, the Brazilian Government approved a similar purchase plan for Companhia Telefonica Brasileira (CTB), the subsidiary of Brazilian Traction that Governor Lacerda attempted to expropriate in March of 1962 resulting in Federal intervention in CTB. Details of the plan were not released.⁹⁴

The actual book value of the AMFORP properties in Brazil was in excess of the \$135,000,000 purchase price agreed upon.

⁹³American & Foreign Power Company Incorporated, Thirty-Ninth Annual Report, 1962, op. cit., pp. 8-9.

⁹⁴New York Times, April 23, 1963, p. 54.

In Chapter II of this thesis it was reported that the 1960 book value was \$147,360,000. The difference between the book and purchase values was the price AMFORP was willing to pay to get out of the utility business in Brazil.

XVII. NATIONALISTS DELAY IMPLEMENTATION OF THE GOULART PLAN

These agreements met a snag before the final contracts could be executed. Nationalistic elements in Brazil, which had been so influential in causing the series of expropriations at the state levels, termed the proposed purchase plans "Yankee robbery", and agitated against the sales.⁹⁵ Governor Brizola, always prominent in the voicing of the nationalist demands, termed the plans a "crime against the state", and demanded expropriation of the properties with the courts fixing the amount of compensation.⁹⁶

As a result of the agitation against the purchase of the foreign-owned utilities and for the expropriation of them instead, signing of the contracts was delayed pending new studies. During July of 1963, a Congressional committee investigated "Leftist" claims that the Federal Government was preparing to pay exorbitant prices for the utilities,

⁹⁵David B. Richardson, "A Country Where Inflation is the Way of Life," U.S. News and World Report, 55:67-69, August 12, 1963.

⁹⁶New York Times, May 30, 1963, p. 3.

particularly AMFORP subsidiaries.⁹⁷ In late July of 1963, the Federal Government stood firm in its intentions to complete the purchases.⁹⁸ However, President Goulart capitulated to nationalistic demands and ordered the Minister of Mines and Energy to restudy the proposed purchase, and re-value the physical properties.⁹⁹

The purchases of the AMFORP and Brazilian Traction subsidiaries, all of the properties of the former company and only the telephone company of the latter, were thus sidetracked in new studies. The purchase plans remained sidetracked from the middle of 1963 to early April of 1964 when the administration of President Goulart was overthrown by a revolution.¹⁰⁰

XVIII. NEW GOVERNMENT'S ACTION UNDER GOULART PLAN--
PURCHASE OF AMERICAN & FOREIGN POWER COMPANY
INCORPORATED SUBSIDIARIES

The administration of President Humberto Castelo Branco, who was installed as President of the revolutionary government in Brazil, appears to have taken a new approach to

⁹⁷New York Times, July 11, 1963, p. 40.

⁹⁸New York Times, July 21, 1963, p. 3.

⁹⁹David B. Richardson, loc. cit.; and American & Foreign Power Company Incorporated, Financial Report of September 30, 1963 (New York: American & Foreign Power Company Incorporated, 1963), p. 3.

¹⁰⁰American & Foreign Power Company Incorporated, Annual Report 1963, (New York: American & Foreign Power Company Incorporated, 1964), p. 13.

utility problems. On June 18, 1964, it was reported that President Branco had offered AMFORP a new deal involving new rate structures for electric light and power services, in an effort to encourage the Company to stay in Brazil. Allegedly, the new rate structures would have permitted an adequate return on AMFORP's investment.¹⁰¹ This proposal was a significant departure from the policy pursued by the previous regime, for it not only offered rate increases, but it also implicitly gave AMFORP the option to stay in Brazilian utilities or leave that industry in accordance with the preliminary agreement worked out under the Goulart Plan.

The crucial distinction between the policy of the new administration and those of previous ones rests upon the different natures of those administrations. Previous administrations, being popularly elected, responded to popular demands for restrictive rate policies and nationalistic attitudes. However, being a revolutionary government, President Branco's administration did not have to respond to popular demands and was free to base its policies more on appraisal of long term needs of economic development than on short term political expediency. Of course, not all revolutionary governments interpret long term needs of economic development as requiring foreign capital in the

¹⁰¹New York Times, June 19, 1964, p. 43.

country's infrastructure, but, in this case, the new government was so inclined since it was created by the military in response to the leftward drift of the previous administration.

Regardless of the policies of the revolutionary administration, foreign investors were really interested in the policies that would be pursued when this administration resigned and restored constitutional rule several years hence. Given the history of regulatory policy based on political expediency under popularly elected leaders, prospects of a resumption of that policy were good when popular rule was restored.

Hence, in spite of the Brazilian request for it to stay under more favorable conditions, AMFORP indicated that it did not intend to remain in the utility business in Brazil, and pressed for resumption of negotiations on the preliminary agreement of April, 1963.¹⁰²

Negotiations were resumed, and, in August of 1964, it was reported that the Brazilian National Security Council had approved the Government's plans for the purchase of AMFORP's subsidiaries. The details of the plans, in which AMFORP substantially concurred, were similar to those in the agreement of April, 1963. At the same time, it was reported that the Government would probably study the purchase

¹⁰²New York Times, June 25, 1964, p. 42.

of Brazilian Traction after arrangements with AMFORP had been completed.¹⁰³

On September 8, 1964, President Branco, in a move to shift responsibility for the plan to popularly elected leaders, asked the Brazilian Congress, recently purged of suspected Communist sympathizers, for authorization to purchase the AMFORP subsidiaries. The measure was described by the New York Times as the most seriously opposed legislation since President Branco took office. Most members of former President Goulart's Labor Party were against the legislation.¹⁰⁴ In addition, outside the Congress, Governor Carlos Lacerda of Guanabara State campaigned against the bill. On one occasion, he charged that the equipment of the AMFORP subsidiaries was obsolete.¹⁰⁵ On another occasion, he protested that Alliance for Progress funds would be requested by the Government to replace money spent on utilities. In addition, he criticized the Government for nationalization of private enterprise and suggested rate increases for utilities as an alternative.¹⁰⁶

On September 24, 1964, a joint Congressional committee

¹⁰³New York Times, August 22, 1964, p. 25.

¹⁰⁴New York Times, September 9, 1964, p. 57.

¹⁰⁵New York Times, August 28, 1964, p. 36; and New York Times, September 2, 1964, p. 36.

¹⁰⁶New York Times, September 9, 1964, p. 57.

approved the measure of President Branco, after having examined an exchange of letters between former Presidents Kennedy and Goulart approving the Brazilian purchase of AMFORP's subsidiaries. In the process, the committee rejected sixty-eight amendments to the bill and two substitute measures.¹⁰⁷

After several weeks of filibuster by the Brazilian Labor Party, on October 7, 1964, the administration measure was passed by a vote of 196 to 91 in the Chamber of Deputies and 32 to 15 in the Senate. Labor Party efforts to vote on the bill section by section were defeated and sixty-five amendments were rejected.¹⁰⁸

The terms of the measure were similar to those of the preliminary agreement of April, 1963. The Government of Brazil was to give AMFORP: (1), \$10,000,000 as a down payment for the properties; (2) Dollar notes for \$24,750,000 earning 6 percent annually with repayment scheduled over twenty-two years; (3), Dollar notes for \$100,250,000 earning $6\frac{1}{2}$ percent annually with repayment scheduled over a second twenty-two year period; (4), \$10,000,000 as compensation for the delay in implementing the April, 1963, agreement; and (5), \$7,700,000 in accrued interest and dividends from subsidiaries. In addition, the Brazilian Government was to

¹⁰⁷New York Times, September 25, 1964, p. 60.

¹⁰⁸New York Times, October 8, 1964, p. 63.

assume all indebtedness of the subsidiaries, primarily to the Export-Import Bank of Washington. For its part, by accepting the notes, AMFORP was to invest in the Government power agency, "Electrobras", some 75 percent of the payment for physical properties, with repayment spread out over a forty-five year period. All transactions were to be exempt from Brazilian taxes. Hence, AMFORP was to receive \$135,000,000 for its investment in the Brazilian subsidiaries and \$17,700,000 in uncollected income from the properties. As a result of the payments schedule, AMFORP was to realize roughly \$16,000,000 in cash in early 1965 on properties that had contributed essentially nothing in the three previous years. This would have made all income booked by AMFORP from all its investments in various Latin American nations more than 50 percent derived from non-utility operations. The President of AMFORP, Henry B. Sargent, termed the measure passed by the Brazilian Congress a "fair and reasonable settlement."¹⁰⁹

On October 14, 1964, President Branco signed the measure into law.¹¹⁰ On November 12, 1964--after confirmation of the valuation was made by an independent appraiser, as called for in the law--AMFORP and the Brazilian Government

¹⁰⁹New York Times, October 8, 1964, p. 63; and New York Times, October 12, 1964, p. 45.

¹¹⁰New York Times, October 15, 1964, p. 55.

signed the agreement, thus ending AMFORP's interests in Brazilian utilities except for receipt of payments.¹¹¹

XIX. CONCLUSIONS

In concluding this discussion of the Brazilian moves to nationalize electric light and power and telephone utilities, one should recall that, prior to those moves, the utility situation had progressed to a rather unstable position. In the face of popular opposition to rate increases, regulatory authorities pursued restrictive rate-making policies that reduced the ability of the enterprises to either generate internal sources of funds or draw upon external sources for expansion. Inevitably the growth of utility services could not keep up with the demand for them, in spite of heavy public investment in new enterprises, so that services deteriorated, imperiling the Brazilian economy and future economic growth. Public opinion demanded remedial action, and spurred on by nationalistic feelings, popularly elected leaders moved to nationalize the utilities as described in this chapter.

The initiative for nationalization of utilities came from the Brazilian States. In 1959, a subsidiary of American & Foreign Power Company Incorporated (AMFORP) was expropriated in Rio Grande do Sul. That action inspired a number of other expropriation threats, but none of these were carried out at

¹¹¹New York Times, November 13, 1964, p. 48.

that time. In 1962, again in Rio Grande do Sul, a subsidiary of International Telephone and Telegraph Corporation (ITT) was expropriated. This action, unlike the previous one, created a stir in the United States so as to imperil Brazil's receipt of further foreign aid under the Alliance for Progress program. As well, the action fired up renewed nationalistic demands for more expropriations. In order to protect its relations with the United States, the Federal Government of Brazil was forced into the settlement of the case, to the point of advancing indemnification funds pending resolution of the matter in the Courts, even though the State had Constitutional jurisdiction.

As it became apparent that the Federal Government was probably going to pay for the ITT settlement, and was considering a negotiated transfer of all foreign-owned utilities to Brazilian hands, other states realized that they, too, could satisfy nationalistic demands by expropriating utilities without worry of compensation requirements. Hence, further expropriation attempts followed, most notably the one involving a telephone subsidiary of Brazilian Traction, Light and Power Company, Limited (Brazilian Traction) in Guanabara State.

In order to prevent the telephone situation from getting out of hand and interfering with Brazil's foreign relations, the Federal Government decreed "intervention" in the cases

and forbade further expropriations of telephone companies without its prior approval. "Intervention" was in name only, for, in fact, the Federal Government did nothing more than appoint an official to sit in one company's office and represent the Government's authority. The companies intervened in continued normal operations.

Shortly after the Federal Government intervened in the Guanabara case involving Brazilian Traction, it announced the Goulart Plan under which the foreign-owned utilities would be purchased through negotiations. The plan was carried through to the point that preliminary agreements were signed in 1963 for the purchase of all of AMFORP's properties and Brazilian Traction's telephone properties. Nationalists, however, cried "Yankee robbery" and demanded expropriation instead with the courts fixing the amount of compensation. The Federal Government consequently ordered a restudy of the agreements, thus sidetracking them.

Under a new, revolutionary administration, the Brazilian Government has agreed to complete the 1963 agreements if the various foreign-owned utilities so desire. In November, 1964, arrangements for the purchase of subsidiaries of AMFORP were completed, terminating that Company's activity in Brazilian utilities.

The conflict regarding utility ownership in Brazil has not yet come to rest. The majority of the nation's electric

light and power and telephone utilities are still owned by foreign companies, primarily Brazilian Traction. Although the short term prospects for these utilities appear to be good under a revolutionary administration, the long term prospects do not appear to be so good, for return to constitutional rule in Brazil may well bring a return to regulatory policies based on political expediency and nationalistic attitudes. Meanwhile, the uncertainty created by the assorted nationalization moves, and the long term prospects of eventual nationalization of the utilities remaining in private hands can only act as a deterrent to further private investment. This, of course, may lead to further deterioration of utility services and even greater public agitation for nationalization.

The discussion in this chapter illustrates the choice Brazil has made with respect to private, especially foreign, capital. Rather than create an atmosphere conducive to continued private investment in utilities, Brazil elected to create a dissuasive atmosphere, with the inevitable result--poor performance of privately-owned utilities. Indeed, that choice eventually encompassed nationalization of many privately-owned enterprises. The next chapter will examine alternate strategies Brazil could have elected and why it did not elect these.

CHAPTER VII

NATIONALIZATION OF BRAZILIAN PUBLIC UTILITIES: THE LOGICAL STEP

The preceding chapters have documented in detail the electric light and power and telephone utility situation in Brazil, including: (1), the role of foreign and domestic capital in the Brazilian infrastructure; (2), the regulatory system under which the utilities operated; (3), the consequences of that system on utility earnings and the quality of service rendered; (4), the climate of public opinion bearing on investment in utilities; and (5), the Brazilian moves to nationalize utilities. In concluding this thesis, we shall examine the alternate strategies facing both the utilities and the Brazilian Government in order to see if there was any way nationalization of utilities could have been avoided.

I. THE SITUATION FOREIGN COMPANIES FACED

The foreign-owned utility companies--American & Foreign Power Company Incorporated (AMFORP), Brazilian Traction, Light and Power Company, Limited (Brazilian Traction), and International Telephone and Telegraph Corporation (ITT)--held prodigious responsibilities in Brazil. Because they

dominated the infrastructure of the Brazilian economy, their output of electric power was essential to the functioning of industry, and their supply of telephones was vital to the nation's telecommunications system. The investment of those companies had an important role in past development of Brazil; their ability or willingness to invest further had a potentially considerable impact on future economic development.

This sort of responsibility to the economy and its development makes host countries wary of foreign capital. A few managers in the United States and Canada possessed considerable control over the Brazilian economy, and both the managers and the Brazilians were aware of it. The managers were also, no doubt, cognizant of the possible Brazilian reactions to their power. Any host government would be quick to nationalize a foreign enterprise located in a vital area of the economy if that enterprise was causing the economy or its development to suffer. Hence, the foreign-owned utilities were compelled to fulfill their responsibilities to the Brazilian economy and its development if they wished to secure their investments; if they failed to fulfill those responsibilities, they were in trouble.

In Brazil, there were two factors that directly hindered the foreign-owned utilities in the fulfillment of their

obligations to economic development in that nation.

First, and most important, the regulatory system for utilities in Brazil and its administration impaired the earnings performance of both foreign-owned and Brazilian-owned enterprises. The regulatory system, first established in 1934 and modified in subsequent years, fixed by law a rate-making formula that reckoned earnings as a fixed percentage of the historical cost of investment. This formula had no ability to account for an inflationary environment. Hence, in subsequent years, earnings of utilities in Brazil, both domestic and foreign, had little purchasing power in relation to current prices, either in Brazil or abroad.

The administration of the regulatory formula impaired the earnings performance of utilities even further. Responsibility for setting utility rates was established within the executive branch of government, and regulatory decisions were not subject to judicial review. Regulatory authorities, therefore, responded more to popular demands than to the needs of long range planning. Since popular demands called for resistance to inflationary trends such as utility rate increases, rate-making authorities tended to delay granting utilities increases in rates required to offset increases in operating expenses.

Second, complicating the effects of the regulatory system, Brazilian management of the foreign exchange markets,

besides affecting the economy as a whole, had a large impact on the earnings performance of the foreign-owned utilities. In the immediate years following World War II, Brazil kept its Cruzeiro to Dollar rate of exchange too low. In effect, this gave the foreign-owned utilities a subsidy on both capital equipment purchases abroad and earnings transfers. Naturally, this partially offset the decline in purchasing power of their Brazilian earnings, but it also obscured the nature of the regulatory problem and made them more vulnerable to changes in the foreign exchange system. These changes came when Brazil's foreign exchange reserves were depleted by the artificially low rate of exchange. During the 1950's, the foreign exchange system was revised several times, each revision removing a portion of the subsidies the utilities had been receiving. Revisions, however, never fully rectified recurrent foreign exchange crises that sometimes impaired capital transactions of utilities, further hindering their ability to service the Brazilian economy.

These two factors, especially the former, were major determinants of the performance of foreign-owned utilities in Brazil. In Chapter IV, we saw the effects of these on the earnings performance of the utilities. As a result of the poor earnings performance, the utilities were unable to generate sufficient internal sources of funds or to draw upon adequate quantities of external debt or equity sources

of private capital for expansion. In fact, since the Second World War, the major portion of funds raised for expansion came from the utilities themselves and international banks. Because of the scarcity of funds during this period, utility services could not grow as rapidly as the demand for them, imperiling economic growth in Brazil.

Besides these two factors directly affecting the ability of foreign-owned utilities to service the Brazilian economy, there was another factor that indirectly affected their ability. In recent decades, nationalism has been growing in Brazil, partly as a result of the economic development serviced by the foreign-owned utilities. Nationalism influenced utility operations in two ways. In one way, the utilities had to operate in an increasingly hostile environment, for nationalism implied hostility toward foreign capital. In another way, nationalism encouraged regulatory authorities to be even less considerate of the needs of foreign-owned utilities than they would have otherwise been. We have already seen that, in response to popular resistance, regulatory authorities were reluctant to grant any utilities, domestic or foreign, rate increases. Nationalism increased that reluctance with respect to foreign-owned utilities. It implied that the interests of foreign investors in earning a profit should be sacrificed so that Brazilians might enjoy cheap utility prices. Such a nationalistic view was

shortsighted, for by seeking to impair the earnings performance of the foreign-owned utilities, it also impaired the ability of those utilities to service the Brazilian economy.

In response to the shortages of utility services and the detrimental effects on economic growth, Brazil undertook utility investment of its own in new projects. Whereas at the end of the Second World War there was essentially no public investment in utilities, at the end of the 1950's there was a significant amount. This investment, however, was not sufficient to remedy the shortages.

Because of the factors that impaired the performance of the foreign-owned utilities, services were not provided by these utilities in adequate quantities, and economic growth in Brazil was thereby imperiled. Hence, the utilities could not fulfill their responsibilities with respect to economic development. As mentioned above, such failure alone made their investments insecure.

Factors that impaired their performance made their investments even more insecure. Basically, there were these ingredients in the utility situation in Brazil, exclusive of the foreign exchange market: (1), regulatory policies that were detrimental to the performance of private capital; (2), growing public investment; and (3), growing nationalism. Added together, these ingredients could only be interpreted as trouble for the foreign investors, possibly to the point

of nationalization of their properties, for they describe an environment disposed toward public ownership of the infrastructure. In fact, it could be argued that these elements were evidence of a thinly veiled government campaign against private capital, although there is no positive proof to show that a concerted campaign actually existed.

It might be naive to suppose that the foreign-owned utilities were neither aware of the likely consequences of failure to meet their responsibilities to Brazilian economic development nor aware of the significance of the factors that made them unable to meet those responsibilities.

II. EXPERIENCE IN OTHER LATIN AMERICAN NATIONS

There were lessons from earlier experiences of utilities in other Latin American nations. As mentioned in Chapter I, other Latin American nations--such as Argentina, Colombia, Venezuela, and Mexico--have been moving toward nationalization of foreign-owned utilities in those respective nations. For example, AMFORP sold its properties in Argentina in 1958, in Mexico in 1960, in Colombia in 1962, and in Venezuela in 1964. The background conditions leading up to those sales were similar to the Brazilian experience. Regulatory authorities, in response to popular demands, were not allowing foreign-owned utilities adequate earnings on their investment. The utilities, therefore, were unable to properly service

the economies of the respective host nations, and hence, were unable to fulfill their responsibilities to economic development. In conjunction with these conditions, growing nationalism created a hostile environment.

Given the parallels of these experiences, the foreign-owned utilities in Brazil clearly were able to understand the import of the conditions in that nation and the likely eventual outcomes of those conditions.

III. EARLY NATIONALIZATION EXPERIENCE IN BRAZIL

Even within Brazil, however, there were similar, earlier experiences the foreign-owned utilities could have learned from. For example, Brazilian railroads, which had been developed primarily by British and French capital, faced rapid economic development coupled with rate regulation that made no allowance for inflationary effects on the purchasing power of earnings. The railroads, thereby, were unable to finance adequate expansion and improvements so that "maintenance of the transportation system went by default over the last 25 years until it reached a state of disrepair and obsolescence as to imperil the national economy."¹ In consequence, railroads were gradually nationalized by Brazil, and, in 1959, only 13 percent of the track ownership

¹Joint Brazil-United States Economic Development Commission, The Development of Brazil (Washington: U. S. Government Printing Office, 1954), pp. 83 ff.

remained in the hands of private capital.²

In addition, in Chapter VI, we have seen the experiences of the foreign-owned utilities in the provision of other public services such as gas, water, and local transportation. Again, regulatory authorities imposed inadequate rates on these services, and the foreign-owned utilities, often willingly, turned their operations over to local authorities.

IV. STRATEGIES FOR THE FOREIGN COMPANIES

Thus, the foreign-owned utilities in Brazil had several lessons to reflect upon, namely: (1), their own inability to service the Brazilian economy as required of them, and the reasons for that inability; (2), similar experiences in other Latin American nations; (3), experience of Brazilian railroads; and (4), their own experience in the provision of local gas, water, and tramway services in Brazil. It was thus reasonably clear to the utilities that nationalization of their electric light and power and telephone operations was a possible consequence of the Brazilian utility problems, for the Brazilians were not likely to do nothing while economic growth was endangered. The only question perhaps not clear was when nationalization might have occurred if nothing was done to correct the deterioration of services.

It is useful, therefore, to examine what basic strategies

²United States Department of Commerce, Brazil (Washington: U.S. Government Printing Office, 1961), p. 136.

the utilities might have followed in light of these lessons in efforts to resolve any conflicts between their responsibilities to their shareholders and their responsibilities to the Brazilian economy.

First, the utilities could have simply abandoned their properties and left Brazil. Such a strategy might or might have not benefited Brazil, but it would have lost everything for the shareholders.

Second, the utilities could have refused to render service unless they received adequate rates. Given the political hostility toward utilities in Brazil, such a strategy would have probably resulted in immediate expropriation of the utilities.

Third, the utilities could have sold their Brazilian operations to other private investors, either in Brazil or abroad. It probably would have mattered little to Brazil whether one private enterprise or another owned a particular utility operation. For the shareholders of the foreign-owned utilities, however, such a strategy would have been costly, for it was improbable that the utility enterprises could have been sold for anything near their book value, let alone their replacement value, given their poor earnings performance.

Fourth, the utilities could have solicited more investment from Brazilians in order to have created a political voice in Brazil. We have seen, however, that Brazilian

regulatory authorities were indifferent to the needs of both domestic and foreign utility capital. In addition, Brazilian investors had already demonstrated a lack of substantial interest in utility investments because of the poor earnings performance of the enterprises.

Fifth, the foreign-owned utilities could have invested even more in Brazil in order to have prevented the deterioration of their services. From Brazil's point of view, such a strategy would have been beneficial to the nation's economy. It is not so clear, however, that this would have benefited the shareholders of the foreign-owned utilities. It is true that the deterioration of services enhanced the risk of nationalization. It is not necessarily true that nationalization would not have occurred had there been no deterioration of services. As we have seen, the factors that impaired the performance of the utilities and the hostile environment were indicative, in themselves, of possible eventual nationalization of the foreign-owned utilities. Hence, additional investment to offset the deterioration of services carried considerable risk to shareholders anyway. Furthermore, private investors were not willing to supply the foreign-owned utilities the quantities of capital required for the necessary expansion of services, and this strategy was physically impossible to pursue.

Sixth, the foreign-owned utilities could have tried to

change the environment in which they were working. That is, they could have sought to change the regulatory system, the inflationary environment, or the climate of public opinion. It is not known to what extent the foreign-owned utilities tried to change these, but changing such conditions would have been exceedingly difficult, and probably beyond the resources of the utilities. In Chapter III, we saw that proposals to revise the regulatory system to allow for re-valuation of utility assets for rate-making purposes were never completed, because, as indicated in Chapter V, popular opinion was opposed to inflationary trends. Hence, modification of the regulatory system would have required modification of public opposition to inflation. The difficulties of convincing a population that inflation was not harmful are all too obvious. As for inflation itself, there was little the utilities could do to halt it when public opinion had already failed to do so.

Seventh, the utilities could have ceased to make any further investment in Brazil until conditions for that investment improved. Utility services, however, would have deteriorated considerably more than they did, increasing the likelihood of nationalization of existing assets. From the point of view of both Brazil and the shareholders of the foreign-owned utilities, this strategy did not have much to offer.

Eighth, the utilities could have continued to invest at levels consistent with their resources. In fact, as is evident from Chapter IV, this strategy approximates the one selected by the foreign-owned utilities. They continued to invest large proportions of their earnings, while still remitting some, and they drew upon external sources of capital to the extent possible. This strategy enabled the utilities to expand their services to a certain degree, and lessened the risk of nationalization. Nonetheless, the inadequacy of this strategy was made evident by subsequent events. This type of strategy sought to forestall nationalization as long as possible in hope that conditions would improve.

Finally, the utilities could have sold their enterprises to the Brazilian Government on the best possible terms. From the point of view of the shareholders in the foreign-owned utilities, this strategy would have been one of the more satisfactory ones, for, providing the terms of sale were reasonable, it would have freed their capital for more productive purposes. From the point of view of the Brazilian Government, however, this strategy might not have been one of the better ones because it would have diverted the Government's scarce resources into existing enterprises rather than into new public projects. On the other hand, it would have given the Government the opportunity to improve the services and to remove a source of friction in international

relations. Eventually, the foreign-owned utilities did elect to pursue this strategy, but not until the nationalistic demands for expropriations were reasonably audible. At first, Brazil did not respond to proposals for the purchase of the utilities, because nationalistic demands were opposed to terms that would have made purchases possible. It was not until a revolutionary government took power in Brazil that the Government was able to complete any arrangements for the transfer of utilities to public ownership.

Most of these strategies were really not very satisfactory in resolving the conflicts of the foreign-owned utilities between their responsibilities to their shareholders and the responsibilities to the Brazilian economy. Some were impossible to pursue. For example, the utilities could not have raised funds sufficient to prevent the deterioration of service. Others would have been costly to the shareholders. For example, any of the above strategies that would have increased the likelihood of nationalization would have increased the risk of unfavorable terms of compensation. The only strategy that offered the best hope to the investor in the foreign-owned utilities was the one calling for the sale of the utility properties to the Brazilian Government, providing, of course, equitable terms of compensation could have been arranged. In addition, this same strategy, although it would have diverted scarce public funds from

other public projects in repayment of the former owners, would have given the Brazilian Government the opportunity to correct the deficiency of services, which private capital could not do. Given the utility environment in Brazil, there was no other satisfactory strategy for the foreign-owned utilities, for there was no way for them to cope with the situation except to make the best of it as far as their shareholders were concerned. Sale of the utility properties to Brazil meant nationalization.

V. ALTERNATIVES FOR BRAZILIAN UTILITY POLICY

The bad situation faced by foreign-owned utilities in Brazil, and domestic utilities as well, was determined by the utility environment, and, in turn, the environment was created by Brazilian Government policy--at the local, State, or Federal level. As a result of Brazilian policies, both domestic and foreign-owned utilities were unable to provide adequate quantities of service for economic development. Brazilian policy, then, was faced with the problem of how to rectify the utility situation so as to prevent imperilment of economic growth. Here, we consider various alternative strategies that were available to the Federal Government of Brazil.

First, one policy could have been to do nothing while the services continued to interfere with economic growth. Throughout the 1950's, this was the policy followed.

Inevitably, however, the detrimental effects on the economy and the public outcry ended this policy. Brazil could not have afforded to continue this policy for long if sustained economic growth was to have been achieved.

Second, the Brazilian Government could have subsidized the utilities. In effect, this was done during the postwar years through the foreign exchange markets by allowing utilities preferential rates of exchange. However, broader considerations of easing the recurrent foreign exchange crises did not favor such a policy; nor did popular opinion with growing nationalistic feelings favor this policy, for the principle beneficiaries were the foreign-owned utilities. Hence, the foreign exchange subsidies were eventually abolished. For similar considerations of political expediency in response to nationalistic feelings, direct subsidies to utilities, especially foreign-owned ones, were not practical alternatives for the Brazilian Government.

Third, the Brazilian Government could have provided the needed services itself through public investment in new utility projects. This strategy would have been of limited value, however, in that it did not satisfy the demands of certain nationalists for elimination of foreign interests in the Brazilian infrastructure. In addition, its value would have been limited in the rectification of inadequate service. For one, public investment in utilities required

large capital expenditures, expenditures which Brazil could not really afford in view of other pressing needs for schools and the like. For another, although direct public investment would have reduced the burden of providing service on the privately owned utilities, it could not have eliminated it altogether. The key distribution systems for both electric power and telephones were dominated by private capital, which was not able to finance expansion of its existing facilities. Although this strategy has been followed to a certain extent, it did not eliminate shortages of services, as is evident from Chapter IV.

Fourth, the Brazilian Government could have made low cost loans available to the utilities. Apparently, as shown in Chapter IV, it elected not to follow this strategy to any great degree. The problems of loans to utilities were similar to the problems of direct public investment--scarce resources. In addition, this strategy would not have been responsive to nationalistic demands of some segments of the public, for, rather than contributing to the elimination of foreign interests, it would have aided foreign-owned utilities. Hence, there was an understandable preference for direct public investment of scarce resources instead of indirect investment in existing enterprises.

Fifth, the Brazilian Government could have revised the regulatory system--not only its formula, but also its

administration. This would have allowed private capital rate increases permitting adequate earnings. However, we have already seen that popular opposition to rate increases and popular hostility toward foreign-owned utilities made this a politically inexpedient move for elected leaders. For example, efforts by some Brazilian leaders to temporarily remedy the situation--through a one time, revaluation of utility assets for rate-making purposes--failed. It was unfortunate that elected leaders in Brazil did not press for reform of the regulatory system. Had the utilities, foreign or domestic, been allowed reasonable and adequate return to their capital, services would not have deteriorated, public investment would not have been necessary, Brazilian acquisition of bankrupt enterprises could have been avoided, and international relations with foreign countries such as the United States would not have been jeopardized.

Sixth, the Brazilian Government could have eliminated the inflationary environment that caused the purchasing power of utility earnings to decline. Unfortunately, Brazilian leaders could not or would not institute the necessary reforms to effect this strategy. There were broader considerations in the control of inflation than merely the problems of utilities.

None of the above alternatives was really an operational strategy for Brazilian policy in coping with the public

utility problems. The country could ill afford to do nothing; nor could it afford to make the needed investments itself. Subsidizing the utilities or revising the regulatory system both were politically inexpedient, especially in view of nationalistic hostility toward foreign-owned utilities, although revision of the regulatory system was the most desirable alternative. There was simply no way, in view of political considerations, for popularly elected leaders to create an atmosphere conducive to private investment.

VI. NATIONALIZATION: THE LOGICAL STEP

There was one other strategy available to Brazil, a strategy that was both politically expedient and capable of rectifying the shortages of services, and that was nationalization of the utilities. Nationalization of the utilities, especially the foreign-owned ones, would have: (1), enabled elected leaders in Brazil to satisfy popular demands for nationalization of the foreign-owned utilities; (2), given Brazil an opportunity to correct the deficiencies of service, although whether or not this would have been achieved in practice is another question; (3), eliminated a source of friction between Brazil and other nations, providing the terms of compensation for nationalization were reasonable; (4), permitted Brazil to pursue whatever rate policy it desired without regards to the needs of capital; and, (5), allowed Brazil complete freedom in development of new utility

facilities or integration of old ones.

There were, of course, disadvantages as well in such a strategy. First, Government ownership of utilities would have required the Government to assume the losses in their operation if the rates were maintained too low, which was likely since popular opinion called for low rates. Second, in order to continue receiving large amounts of foreign aid and foreign investment in other industries, Brazil would have had to agree to terms of compensation that were acceptable to foreign investors. This meant fair compensation as defined by the United States Foreign Assistance Act of 1962, equitable and speedy compensation in convertible foreign exchange. Hence, Brazil would have been required to assume large obligations to the foreign investors, obligations that diverted earnings of Government utilities from needed expansion of service to repayment of foreign debt.

One might argue that if the Brazilians could have financially afforded to pursue this policy, while incurring obligations to the former owners, they could have financially afforded two of the other alternatives--direct public investment in new projects or indirect public investment through loans to existing enterprises. Were it not for the fact that the foreign-owned utilities were willing to offer easy terms for repayment, as evidenced by the long term notes AMFORP accepted in its sale of its subsidiaries, this

argument would be correct. The real crucial distinction, however, lay in the results of the strategies. Nationalization would have eliminated foreign interests, while the other strategies would not have done so. In other words, taking political factors into consideration, nationalization had more advantages in the aggregate than the other two strategies.

As we have seen in Chapter VI, nationalization was the strategy eventually chosen by Brazil. The first moves to nationalize utilities originated at the State level through a series of expropriations with compensation offered on terms that clearly were not acceptable to the foreign investors. The Federal Government of Brazil, in order to preserve friendly foreign relations, took over the nationalization drive from the States and offered to negotiate equitable settlements with the foreign investors. The Federal Government, however, once it established its authority in utility nationalizations, could have elected to return the properties to the owners rather than to continue the nationalization policy. The choice was clear, for political expediency, in deference to popular demands, favored nationalization.

The whole utility problem in Brazil was really a political one. In the Brazilian political system, popularly elected leaders responded to popular demands, with little

regard to preparing for the future, and popular demands posed a series of unresolvable conflicts. Popular opinion demanded that Government regulated industries charge low rates. Popular opinion demanded that economic development be unimpaired by utility shortages. For private capital, there was no way to simultaneously satisfy both demands, for as Brazilian regulatory policy responded to the first demand, utility services deteriorated. And, as utility services deteriorated, popular opinion, in conjunction with growing nationalism, demanded the elimination of private capital, especially foreign capital, in the infrastructure. Hence, as Brazilian leaders moved to satisfy the second demand, that for adequate service, they found that popular opinion prevented them from pursuing any strategy which would have aided private capital in its plight. This situation was degenerative, for as services grew worse, popular opinion grew more vocal about keeping the rates down and eliminating foreign interests, further deteriorating the services. Hence, nationalization, at the expense of the public treasury, was the only logical alternative for Brazilian utility policy.

VII. FUTURE PROSPECTS

We have seen that the utility situation had been developing for a long period and that nationalization moves did not arise solely out of the problems of recent, pronounced

inflation, for, since the onset of regulation, utility services were, in general, unable to keep up with the demand for them.

Brazilian nationalization moves to date have far from eliminated foreign capital in the Brazilian infrastructure. Brazilian Traction, Light and Power Company, Limited (Brazilian Traction), for example, the largest single utility in Brazil, has been essentially untouched. Given the long period the present situation took to develop, it will probably be a long time before nationalization is complete. Brazilian policy, being ad hoc in nature, has been slow to react to long term trends. In addition, the size of Brazilian Traction's investment in Brazil will dissuade the Government of that nation from trying to compensate too many foreign investors at one time.

From time to time we have noted the problems of Brazilian-owned utilities. From an operational point of view, their problems were identical to those of the foreign-owned utilities. Their exposure to nationalization was less, however, because of their ownership. Nonetheless, because of their inability to provide adequate service, and the general public disillusionment with them, they, too, were and are likely objects of eventual nationalization.

Brazilian nationalization moves to date were inevitable because of the political character of the problem. Once the

rigid regulatory system was established, and politics took over its administration, the situation was inherently degenerative due to the manner in which Brazilians concentrated on today and not on tomorrow. The rationale behind the nationalization of the utilities might change only if Brazilian political behavior in this respect should ever change.

APPENDIXES

APPENDIX A

STATE OF RIO GRANDE DO SUL, DECREE NO. 13,186 OF FEBRUARY 16,
1962, EXPROPRIATING COMPANHIA TELEFONICA NACIONAL*

Cancels the authorization used by Companhia Telefonica Nacional, local subsidiary of ("International Telephone and Telegraph Corporation") and declares as of public utility, for desapropriation ends, its properties located in the State of Rio Grande do Sul.

The Governor of the State of Rio grande do Sul using the attributions conferred to him by item XIII of Article 87 of the State Constitution and in conformity to what is disposed in articles 2, 3 and 5, line h, and 6 of Decree-Law 3365 of June 21, 1941.

WHEREAS the present Companhia Telefonica Nacional, previously named Companhia Telefonica Rio Grandense, local subsidiary of "holding company"--International Telephone and Telegraph Corporation, has been operating the telephone services in Rio Grande do Sul since 1927 but under a precarious title, that is, without a contract;

WHEREAS that company has revealed itself incapable of providing the telephone service in a manner that would

*Translation furnished by International Telephone and Telegraph Corporation, New York.

satisfy the necessities of industry, commerce, public services and other social activities;

WHEREAS it is an elementary duty of the Public Power, within the legal limits of its attributions, to provide for the most exact conditioning of public services of a basic character, suiting them to the true indexes of collective needs;

WHEREAS the quality of the services rendered to the Riograndense community by the Companhia Telefonica Nacional tends to become worse, within a negative and agonizing frame, causing a veritable suffocation of the State economy, as tariff demands increase year after year and the service applications imposed by our growth, naturally increase;

WHEREAS the installations and equipment of the Companhia Telefonica Nacional deteriorate more and more, while its financial obligations increase, to a point where the company itself, a subsidiary of "International Telephone and Telegraph Corporation", owes an enormous amount to the foreign parent company, which holds likewise, 98% of her capital;

WHEREAS it is up to the State to safe-guard the collective interests in such a manner as to provide the community with the best public service possible;

WHEREAS the State Governor tried to concilliate the conflicting interests, inviting the Companhia Telefonica Nacional to participate in the mixed economy company, "Companhia

Riograndense de Telecomunicacoes", created by Law No. 4073 of December 30, 1960, to which, at first, CTN agreed to participate in with 25% of CRT's capital, but later created impediments of such a nature that frustrated the intention initially manifested;

WHEREAS the circumstances of general interest and the specific bad conditions of the public service dictated no other alternative to the Executive, but to cancel the precarious authorization, recover the service and expropriate the property related to telephone communications, using of the conceding power he possesses:

DECREES:

Article 1. The authority under precarious title that Companhia Telefonica Nacional (Subsidiary of International Telephone and Telegraph Corp."--ITTC) has been using, for operating telephone services in Rio Grande do Sul, is hereby cancelled.

Sole Paragraph. Consequently, the State of Rio Grande do Sul recovers the services referred to in this article.

Article 2. All properties belonging to the Companhia Telefonica Nacional, related to the telephone services located in the State of Rio Grande do Sul, are considered of public utility, for expropriation purposes.

Sole Paragraph--Also included in the scope of this article, are the accounting books, official and optional,

the files and respective documentation.

Article 3. The present expropriation is declared urgent for the effect of transmission to the State, for possession, of all properties object of this Decree, as per terms of Art. 15 of Decree-Law 3365 of June 21, 1941, with the text given to it by Law 2786 of May 21, 1956, in its article 2 and respective paragraphs.

Article 4. This Decree will be effective on the date of its publication and all dispositions to the contrary are hereby revoked.

Piratini Palace, in Porto Alegre, February 16, 1962,
signed by the Governor and all the State secretaries.

APPENDIX B

FEDERAL DECREE NO. 640 OF MARCH 2, 1962*

Defines Telecommunications Service as a basic industry and establishes other measures.

The President of the Council of Ministers, as empowered by Art. 18 Item III of the Constitution (Additional Act re Parliamentary Government).

CONSIDERING that the grave crisis in telecommunications is affecting the good operation of public affairs, the national safety and the normal economic development of the country;

CONSIDERING that said crisis tends to become worse, owing to deficiencies in the private companies that operate the service, especially the lack of flexibility in the use of funds within their reach which might be employed without further detriment to the users of the service and to public opinion itself;

CONSIDERING that the National Congress, in bills which they are examining, have already recognized the magnitude of the problem and the national interest involved, also that

*Translation of Decree published in (Federal) Diario Oficial of March 2, 1962, Section I--PartI--p. 2519, furnished by International Telephone and Telegraph Corporation, New York.

more exact norms are under way for regulating the matter;

CONSIDERING that, for all the above reasons, it is important to preserve the existing services and stimulate their development so that it may be possible to establish, within the shortest period, a plan for telecommunications based on a national organizational directive already in its final stages of elaboration;

IT IS DECREED:

Article 1. For all legal purposes, telecommunication services are considered basic industry, of interest to the promotion of the country's economy and of relevant significance to national security.

Item 1--The Banco Nacional do Desenvolvimento Economico is hereby authorized to consider as priority operations any operation which might be made for the purpose of developing and re-equipping said industry.

Item 2--For the purpose mentioned in the previous paragraph, the Banco Nacional Desenvolvimento Economico may acquire by purchase or subrogative the shares of concessionaire companies and also undertake other actions of banking nature.

Item 3--When the financing or investment is due to government action through the initiative of the President of the Council of Ministers, the Banco Nacional do Desenvolvimento Economico may also act as set forth in Art. 8 of law

no. 1628 of the 20th of June, 1952.*

Article 2. Present Decree goes into effect on the date of its publication and all dispositions to the contrary are revoked.

Brasilia, on the 2nd of March, 1962, 141st of the Independence and the 74th of the Republic,

TANCREDO NEVES
Alfredo Nasser
Walter Moreira Salles
Virgilio Tavora

Angelo Nolasco de Almeida
Joao de Segadas Vianna
Clovis N. Travassos
Ulysses Guimaraes.

*Legislation creating Banco Nacional do Desenvolvimento Economico and empowering it to "act as the government's agent in financial operations related to the re-equipping and promotion of the national economy".

APPENDIX C

FEDERAL DECREE NO. 790 OF MARCH 27, 1962*

Regulates with respect to provisions necessary to the discipline and betterment of interstate telephone services.

The President of the Council of Ministers, using the attribution to him conferred in Article 18, item III, of the Additional Act to the Federal Constitution and Article 99 of Law no. 3089 of January 8, 1916.

CONSIDERING that Article 5, item XII, of the Federal Constitution, granted competence to the Union to operate directly or by means of authorization or concession, among others, the interstate telephone services,

CONSIDERING that Article 99 of Law 3089, of January 8, 1916, authorized the government to allow interstate telephone connections by means of provisions which assure to the regular and perfect functioning of communications,

CONSIDERING that by the interdependent nature of telephone services, the deficiencies of inter-state and intra-municipal networks bring about the irregular and imperfect operation of interstate communications,

*Decree published in the (Federal) Diario Oficial on March 27, 1962--Section 1, Part 1--pp. 3480-81; translation furnished by International Telephone and Telegraph Corporation, New York.

CONSIDERING that because of the ever increasing importance which telephone communications are assuming, the Union can no longer remain ommiss in the solution of a problem which affects the national security;

DECREES:

Article 1. For all legal and regulatory effects, telephone services carrying out or effecting communications between two or more states or operating in more than one state, belonging to or under the control of one same concessionary company, are considered interstate.

Article 2. The segregation or separation of the properties, services or patrimony, in whole or in part, by whatever concessionary company of telecommunication services operating them in more than one state will not be made effective, even for purposes of expropriation or take-over of concessions, without previous consent of the Minister of Transport and Public Works who, prior to authorizing the operation, shall hear all interested conceeding authorities, whether state or municipal.

Sole Paragraph--In the hypothesis of this article, an opinion from the National Security Counsel shall always be requested.

Article 3. Companies affected by this Decree shall hereby fall within the fiscalization of the Ministry of

Transport and Public Works, without prejudice to the fiscalization now exercised by conceding state or municipal authorities.

Article 4. Companies authorized by the Federal Government to operate interstate telephone services under the terms of Article 99 of Law 3089 of January 8, 1916, shall collect from all users of the local or toll services connected to the interstate service network, tariffs beyond the current ones or those which may be authorized by State or Municipal Authorities.

Article 5. The tariff referred to in the preceding article will be established by a Resolution issued by the Minister of Transport and Public Works, at the request of the interested companies.

Sole Paragraph. This tariff shall be periodically revised in function of the plans for expansion of the services and needs of the company, considering the conditions of each of the state concessions and having in view, whenever possible, the uniformity of total tariffs to be paid by the users in areas in which the company operates.

Article 6. The revenues from this special tariff collected by the companies shall be deposited monthly in the National Bank of Economic Development* (BNDE) to the order of the Ministry of Transport and Public Works.

*Banco Nacional do Desenvolvimento Economico.

Article 7. The Minister of Transport and Public Works shall issue such instructions as may be necessary to assure the perfect execution of this DECREE and the definition of the system of interstate tariff and their application including what refers to the use of the deposited funds.

Article 8. This DECREE shall enter into force on the date of its publication, annulling all dispositions to the contrary.

Brasilia, March 27, 1962

Tancredo Neves
Virgilio Tavora

APPENDIX D

FEDERAL DECREE NO. 881 OF APRIL 11, 1962*

DECREES:

Article 1. "The organs for the defense of the Union's interests and rights to all legal effects, including those of article 88 et seq. of Decree-law No. 1,608 of September 18, 1939, shall interfere in any legal process aiming at the expropriation, alienation, or rescission of contract of the telephone service concessionaire companies, the activities of which integrate, by their own means or otherwise, interstate or international connections (Art. 5, part XII, of the Constitution).

Article 2. The Union's litisconsortium in the lawsuits mentioned in the previous article, shall protect the federal policy of implantation and operation of the national telecommunication system, and shall have in view, especially, the compliance with the directions established in Decree No. 790 of March 27, 1962.

Article 3. The intervention established by Decree No. 814 of March 31, 1962, shall be extended, by the intervener appointed for it, if necessary, to the subsidiary companies

*Decree published in Correio da Manhã, April 11, 1962; translation furnished by International Telephone and Telegraph Corporation, New York.

of the Telephone Company, and to the other companies situated in any part of the national territory which, operating in interstate or international services, should be under impending expropriation, alienation, rescission of contract, merger, or dismemberment, without compliance with the conditions established in Decree No. 790 of March 27, 1962.

Sole Paragraph. The intervener shall carry out, in each case, either directly or through a trusted deputy, the measures in the interest of the national security and of the Union's constitutional competence which, within the limits of his attributions, he should deem adequate.

Article 4. The state and municipal telephone services that could be technically dissociated from the interstate and international services, shall remain under control of the local authorities, which shall exploit them directly or through concessions, as they see fit.

Article 5. The intervener shall take all measures to insure that the purposes of the intervention be achieved and finished promptly, and shall, to that effect, be authorized to requisition the necessary officials and to form an executive work-group.

Article 6. The present Decree shall become effective on the date of its publication, the provisions contrary to it being revoked."

Tancredo Neves

APPENDIX E

FEDERAL DECREE NO. 1,106 OF MAY 30, 1962*

Provides for the transfer of public services now under concession to the Government for direct operation and sets forth other provisions.

The President of the Council of Ministers, exercising the authority granted to him by paragraph III of the Supplementary Act, and

WHEREAS, at the present stage of the country's development national interest may be better served by the direct operation of public or public utility services, except in the case of municipal services or those of limited regional scope, where the operation under concessions is justifiable;

WHEREAS, in carrying out the nationalization of public service companies the constitutional provisions guaranteeing private property, both national and foreign must be observed;

WHEREAS, the Council of Ministers, in its Government Program submitted to the National Congress, has recognized the necessity of supplementing the internal formation of capital by the participation of foreign investments in the country so that the levels of economic and social development

*Decree published in the (Federal) Diario Oficial on May 30, 1962; translation furnished by American & Foreign Power Company Incorporated, New York.

required by the demographic growth and by the justified aspirations of social well-being of the Brazilian people may be reached and maintained;

WHEREAS, the nationalization of public service companies should not result in the reduction of foreign investments in the country, nor bring about a climate of discouragement to new investments, nor result in a source of substantial increase in the exchange requirements arising from such investments,

DECREEES:

Article 1. A committee under the authority of the President of the Council of Ministers and composed of three (3) members designated by the President of the Republic is hereby created for the purpose of:

a) submitting to the approval of the Council of Ministers the list of services that should be operated under public ownership and indicating the order of priority;

b) negotiating with the representatives of the concessionaire companies the conditions and form of reimbursement or indemnification to the shareholders and submitting to the Council of Ministers the plan resulting from each one of such negotiations;

Article 2. The conditions for reimbursement or indemnification agreed upon with the concessionaire shall conform

to the following principles:

a) Down payment of a portion not higher than ten percent of the total amount agreed upon;

b) Payment of the deferred portion in installments compatible, whenever possible, with the funds generated by the service itself and a minimum of additional public funds;

c) A minimum of exchange requirements;

d) Obligation of the concessionaires to reinvest in the country in the fields or activities designated by the National Planning Commission as appropriate for the national economic and social development, not less than seventy five percent of the net amounts received as payment or indemnification which amounts may not be employed in the financing or acquisition of an interest in any national enterprises already in operation.

Article 3. For the valuation of the assets and determination of the amounts to be received by the concessionaires as payment or indemnification there shall be carried out negotiations and, whenever necessary, expert examinations and decision (as arbiters) by a representative of the Government, a representative of the concessionaire and a technical expert appointed by mutual agreement of the parties, or, in case of disagreement, by the President of the Council of Ministers, with the approval of the Cabinet.

Article 4. This decree shall become effective on the date of its publication, all provisions to the contrary being hereby revoked.

Brasilia, May 30, 1962. 141st Year of Independence
and 74th Year of the Republic.

/s/ Tancredo Neves
/s/ Alfredo Nasser
/s/ Angelo Nolasco
/s/ Joao de Segadas Vianna
/s/ San Tiago Dantas
/s/ Walther Moreira Salles
/s/ Virgilio Tavora
/s/ Armando Monteiro
/s/ Antonio de Oliveira Brito
/s/ Andre Franco Montoro
/s/ Clovis Travassos
/s/ Souto Maior
/s/ Ulysses Guimaraes
/s/ Gabriel de Rezende Passos

APPENDIX F

FEDERAL DECREE NO. 1,164 OF JUNE 8, 1962*

Amends Article 1 of Decree 1106 of May 30, 1962.

The President of the Council of Ministers, exercising the authority vested in him by paragraph III of the Supplementary Act, hereby decrees:

Article 1. Article 1 of Decree 1106 of May 30, 1962 is hereby amended to read as follows:

"Article 1. A committee under the authority of the President of the Council of Ministers, composed of three members appointed by the President of the Republic and the Presidents of the Banco do Desenvolvimento Economico (BNDE) and ELECTROBRAS (Centrais Eletricas Brasileiras, S.A.) is hereby created for the purpose of:

a) Submitting to the approval of the Council of Ministers a list of the services that should be transferred to the Government for direct operation, indicating the order of priority;

b) Negotiating with the representatives of the concessionaire companies the conditions and form of payment or indemnification of the shareholders, and submitting to the

*Translation furnished by American & Foreign Power Company Incorporated, New York.

Council of Ministers the plan resulting from each of such negotiations;

c) Fixing the standards to be followed in making the inventory and valuation of the concessionaire companies in accordance with [taking into account? "observada"] existing legislation."

Article 2. This decree shall become effective on the date of its publication, all provisions to the contrary being hereby revoked.

Brasilia. June 8, 1962. 141st Year of Independence
and 74th Year of the Republic.

/S/ Tancredo Neves
Alfredo Nasser
Joao de Segadas Vianna
Antonio de Oliveira Brito
Walther Moreira Salles
Virgilio Tavora
Armando Monteiro
Clovis M. Travassos
Ulysses Guimaraes

APPENDIX G

FEDERAL DECREE NO. 1,203 OF JUNE 19, 1962*

Creates the Commission for the Nationalization of Concessionaire Companies of Public Service (CONESP) and sets forth other provisions.

The President of the Council of Ministers, exercising the powers vested in him by Article 18, Item III of the Supplementary Act, hereby decrees:

Article 1. The Commission for the Nationalization of Concessionaire Companies of Public Service (CONESP) exercising the powers provided in Decree No. 1,106 of May 30, 1962, as amended by Decree No. 1,164 of June 8, 1962, shall:

a) establish the general operations procedure of the Commission;

b) approve the setting up of work groups and define their powers.

Article 2. The Commission shall hold meetings upon the call of the President or at the request of one of its members.

Sole Paragraph. The Commission shall meet with the quorum of four of its members, by a majority vote, the President having, moreover, the deciding vote.

*Translation furnished by American & Foreign Power Company Incorporated, New York.

Article 3. The President of the Commission shall:

- a) Represent the Commission in its dealings with the authorities or with third parties;
- b) comply with and make effective the decisions of the Commission;
- c) submit to the President of the Council of Ministers the decisions of the Commission;
- d) issue requests for drawing on the technical and administrative personnel of the Federal Government, autonomous agencies and mixed economy companies;
- e) undertake the administration of the Commission, and delegate his powers.
- f) hire personnel for specific tasks;
- g) present at the meetings of the Commission matters for discussion and consideration;
- h) promote the cooperation of public and private entities for the carrying out of the Commission's objectives.

Sole Paragraph. The President shall have an assistant who shall also act as secretary at the meetings of the Commission.

Article 4. The Commission, integrated by the technical and administrative personnel required for the carrying out of its functions, shall be constituted as follows:

- a) Cabinet
- b) Counsellors
- c) Work groups

Sole Paragraph. The organization of these bodies shall be established by the internal regulations of the Commission which shall be approved by the President of the Council of Ministers.

Article 5. The services of the Commission shall be met by the budgetary appropriations assigned to it, by funds destined to it by the President of the Council of Ministers or funds originating in the bodies of which it is composed.

Sole Paragraph. The expenses of the Commission shall be subject to budget to be approved or amended by resolution of the President of the Council of Ministers.

Article 6. All conflicting provisions are hereby revoked.

Brasilia, D.F. June 19, 1962. 141st Year of Independence
74th Year of the Republic

(signed)

Tancredo Neves
Walther Moreira Salles
Joao de Sagadas Vianna
Antonio de Oliveira Brito
Virgilio Tavora
Armando Monteiro
Clovis M. Travassos
Ulysses Guimaraes
Alfredo Nasser

APPENDIX H

PORTARIA NO. 1 OF AUGUST 29, 1962, OF THE COMMISSION FOR
NATIONALIZATION OF PUBLIC SERVICE CONCESSIONAIRE COMPANIES
(CONESP)*

The President of the Commission for Nationalization of Public Service Concessionaire Companies (CONESP), exercising the authority vested in him by Decree No. 1203 of June 19, 1962, and having in mind the proposal presented by American & Foreign Power Company Inc. of the United States of America for the sale of the stock of its ten associated companies from which form the "Electric Companies Group", hereby resolves to appoint:

Engineer Paulo Romano
Engineer Natercio Pereira
Economist Paulo Mafra

to form a committee, under the presidency of the first named, in order to study the value of the proposed sale based on the books of account, balance sheets and records of the Company and its associated companies as well as the SUMOC registries, and report on the value of such sale in the light of different possible criteria, such as:

*Translation furnished by American & Foreign Power Company Incorporated, New York.

- a) Unadjusted historical cost;
- b) Historical cost adjusted by the application of indices prepared by the National Economic Council pursuant to Article 57 of Law 3470 of 1958;
- c) Historical cost adjusted by the application of the indices of the Getulio Vargas Foundation;
- d) Cost of reproduction.

Rio de Janeiro, August 29, 1962

/S/ Gen. Carlos Berenhauser, Junior
President

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