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Brazilian survival tactic in Volcker's world economy: a draining export drive

by Mark Sonnenblick

Brazil faces "optimal perspectives" of obtaining the $20 billion in new bank lending it needs next year to roll over its foreign debt, Citicorp President Walter Wriston declared Oct. 13, following long sessions with Brazilian authorities. A new mood has replaced the hand-wringing, groans, and threats heard in Brazil just a year ago from David Rockefeller and his tribe. Any foreign banker one might choose to give ear to or any Brazilian economic official will celebrate "Brazil's dramatic success in turning its $2.8 billion trade deficit in 1980 into a slim surplus this year." Brazil exported more in September than in any month in history, Finance Minister Ernane Galvêas announced; and the $245 million trade surplus that month also broke all records (see Figure 1). He ecstatically projected a $1 billion surplus for the year.

It is undeniable that Brazil's economy turned a corner during the past year. But has that turn been toward future prosperity?

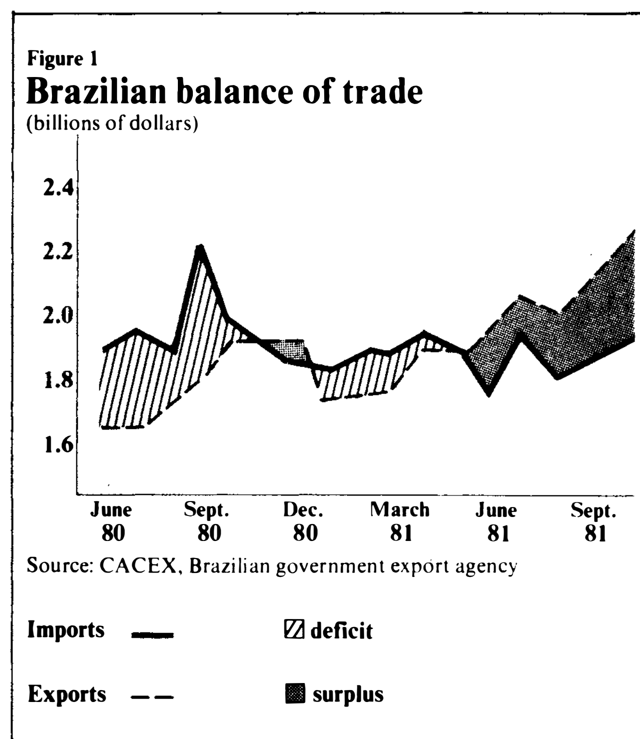

Figure 1
Brazilian balance of trade
(billions of dollars)

Source: CACEX, Brazilian government export agency

Brazil has responded with alacrity to high interest rates on its debts by surgically removing $3 billion from its import-to-export balance. Planning Minister Antônio Delfim Netto attributes this feat to "the painful sacrifices of the Brazilian people" and to his own expertise. He is at least half right. His policies have systematically reduced consumption of manufactured products and food, thereby reducing import demand and freeing domestic production for dumping onto the world market. One-shot boosts to the trade balance arose from both running down record inventories during the course of the year and from a near-record harvest that was brought as much by the grace of God as by the grace of Delfim.

These are transitory, defensive measures which would become economically, as well as politically, unbearable if continued too long. But the attention focused on "how long can Delfim hold" against anti-austerity political pressures has caused much more critical transformations in the shape of Brazilian development to go almost unnoticed. Brazil is in the midst of recycling its entire economy into a new "survival" mode. Starting 1981, it has shrunken and discouraged high-technology investments which require a lot of foreign capital, but are extremely productive. They were the mainstay of what was called "the Brazilian Miracle." As unemployment from auto and related industries mounts, the perpetrators of this policy seek a mandate to throw Brazil fully into the badly capitalized labor-intensive forms of production. If they succeed, the economy, which now generates a quarter of the entire developing world's manufactures, may never have the strength to recover.

This report examines the first phase of Brazil's adaptation to the Volcker shock.

Despite an abundance of "free-enterprise" rhetoric, Brazil has a sophisticated collection of centralized controls which permit Delfim and his crew to fine-tune Brazil's adaption in a way that could not be done under "free-market" conditions. He has been able to rev up an export machine, while draining blood from other sectors—a recipe for suicide if sustained for the "two or three years of sacrifices" Delfim speaks of, or for the three to five years estimated by the American Chamber of Commerce in Brazil. Yet, so far Delfim has manipu-

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lated the levers of political economy with consummate finesse in order not to disturb the delicate political balance in the country and not to blow out the economy.

The 180-degree turn from unbridled growth to recession was effected at the end of last year under incredible blackmail pressure from the Bank of England, David Rockefeller, and their allies among U.S. banks. The banks simply cut off lending to Brazil. Delfim was presented with the choice of letting the IMF bludgeon Brazil with its conditionalities, or of making Brazil a net exporter through his own methods. With no alternative world monetary system in view, Delfim eloquently mocked the IMF, and chose the "sovereign" road to recession. The world's "limits to growth" forces had clearly felt compelled to exterminate the very self-confidence born of Brazil's meteoric rise to the world's eighth largest economy. The World Bank had concluded its late-1977 confidential report on Brazil with the lament, "The Brazilian Miracle ... established great confidence in the long-term growth potential of the country, which has made it difficult to adjust to the necessity of moderating the growth rate as a means of combatting the balance-of-payments and inflation problems Brazil faces today."

While the advanced industrial countries plunged into recessions, the Brazilian military government insisted on continued 8 to 10 percent annual industrial growth. The opponents of Brazil's growth orientation were confounded by the 7.1 percent increase in manufacturing production during 1980.

Then, during the last months of the year, Delfim instituted monetary constraints which look much like those Paul Volcker imposed in the United States. Delfim adroitly cloaked his Dec. 7 announcement of policies which would carry Brazil into a recession. He consecrated Brazil to "free enterprise," eliminated price controls on most goods and on interest rates, cut back wage indexing, and announced curbs on government spending. Specifically, he imposed strict limits on money supply and bank creation of new credit; these have sliced credit available to the economy by over 20 percent in real terms over the course of the year. The credit-shortage/high-interest policy has fully achieved its intended purposes: 1) forcing companies to borrow dollars abroad to help finance Brazil's balance of payments at a time when the Brazilian government had difficulty borrowing; 2) forcing companies to sell off or use up inventories of inputs and finished products, resulting in

Opposing views on a policy of sacrifice

Central Bank President Gerardo Langoni, a friend of Milton Friedman and the host of Paul Volcker's Labor Day sojourn in Brazil, explained Brazil's policy switch to the press after having done so to the Naval War Academy, Oct. 5.

Langoni said, "The superimposition of the financial shock on top of the second oil shock of 1978 made Brazil unable to sustain the strategy of growth accompanied by increasing foreign indebtedness which it followed during the 1974-78 period when foreign interest rates were lower than U.S. inflation levels. Today, interest rates are 5 to 6 percent positive, above U.S. inflation." This, said Langoni, forced Brazil to slow down industry, promote exports, and shift investments into agriculture and alternative energy sources.

Cláudio Haddad, the Central Bank's Public Debt Director, further outlined the strategy Brazilian monetary authorities were pusuing to reduce Brazil's current account deficit during a period of sky-high foreign interest charges (see Figure 3). In an Oct. 11 interview with Rio's daily *Jornal do Commercio,* Haddad stated, "I think that next year we will have to obtain a brutal trade-account surplus in order to gradually close out the current account deficit.... The key to this in terms of political economy is a sectoral re-allocation. We must generate a trade surplus next year; if we bring in a $5 billion surplus on trade, it will be little. We need to capture less foreign savings and more internal savings. Thus, the present monetary and fiscal policies must be maintained. We must produce goods to be sold abroad, more 'tradebles,' and fewer domestic goods."

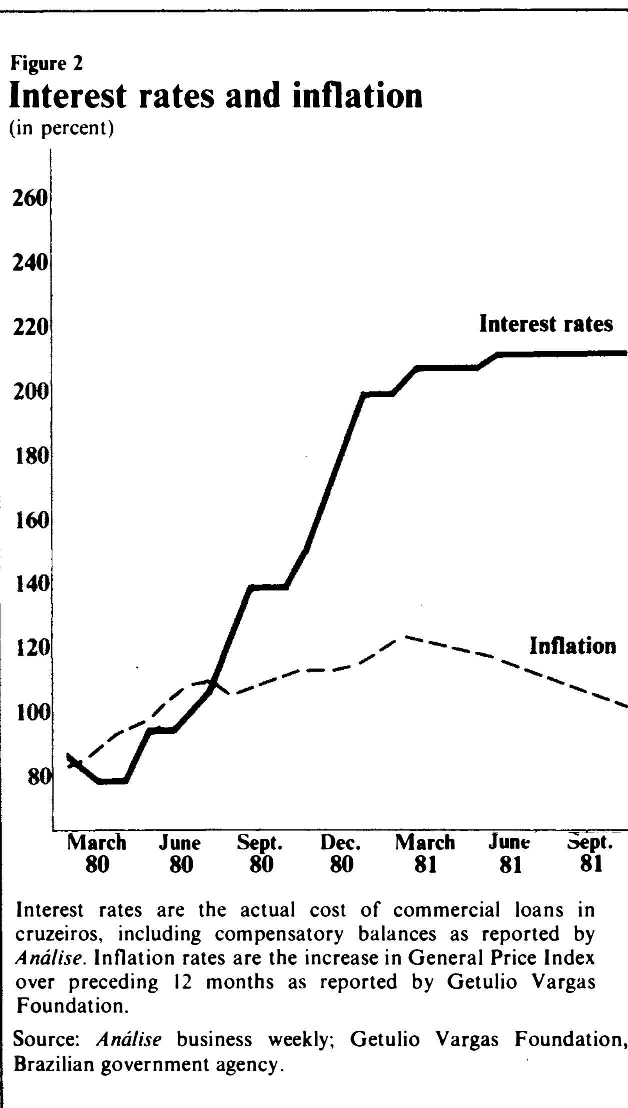
Brazil's Parliament and the majority of the country's industrialists, however, take the opposite view. A formal parliamentary commission of inquiry studied the causes of the high internal inflation rates (see figure 2). Its conclusions were related by Deputy Herbert Levy, an old-time conservative politician, banker, and publisher of Brazil's national business daily *Gazeta Mercantil.* Levy's report states: "We are exchanging a full-scope economic policy which could fully mobilize the human and physical resources available in Brazil which are capable of pulling it out of today's difficulties for an action oriented by mere accounting considerations in order to obtain dollars at any cost, thereby solving immediate balance-of-payments problems, but sacrificing a large part of the population."

bargain prices and reflected in lower inflation statistics and a reduction of imports.

Controlled recession

While making savage use of the Volcker monetarist instruments, the Brazilian authorities do not allow the recessionary effects to be distributed according to President Reagan's "magic of the free market." Instead, they are following the instructions of a report entitled, "New Directions for the Brazilian Economy," prepared in 1977 by the National Institute of Economic and Social Research (INPES) at the behest of the World Bank.

The report postulates: "The aggregate growth rate must decrease. . . . It would be ingenuous to imagine that Brazil can resume high growth in the 1980s." It then dictates how Brazil must systematically triage all capital-intensive industries requiring foreign technology, foreign investment, and foreign inputs. The World Bank advocates that Brazil make itself a South American China, in which family workshops with below minimum wage and labor-intensive export agriculture become the dominant features of the economy.



Interest rates are the actual cost of commercial loans in cruzeiros, including compensatory balances as reported by *Análise*. Inflation rates are the increase in General Price Index over preceding 12 months as reported by Getulio Vargas Foundation.

Source: *Análise* business weekly; Getulio Vargas Foundation, Brazilian government agency.

The World Bank's Maoist prescription for Brazil is phrased in the same Fabian "income redistribution" rhetoric currently employed by Delfim. The São Paulo automobile industry—which served as the keystone of Brazil's recent industrialization—is targeted for extinction as a "misallocation of scarce resources."

Delfim has targeted his economic and monetary controls against the consumer durables sector. He has succeeded in reducing gasoline consumption by 15 percent and domestic auto sales by 30 percent. Ripple effects are spreading through the rest of the economy. Steel production for the year, for example, will be down 11.7 percent from last year's 15.3 million tons.

Total manufacturing during the first seven months was depressed only 5.9 percent from 1980 levels, because many sectors are still working off order backlogs from Brazil's fast-growth period, or are now making the indispensable items they used to purchase from abroad.

Meanwhile, exports of manufactures earned $7.259 billion through August, up 30.8 percent from the same period last year. Manufactures now make up 48 percent of Brazil's exports, compared with infinitesimal quantities a decade ago and 32 percent in 1977. Diversion into export competition is *not* profitable, however, an industrialist at the Brazil Export '81 trade fair which toured six U.S. cities over the past month confided, "We lose money on every export; the prices we get are vile; but the goverment forces us to do it." In today's dirigist Brazilian bureaucracy, demonstrating an excellent export performance is a surer entrée to what remains of subsidized credit and other benefits than "knowing the right people" or paying *pistoleros* (fixers).

It is the Brazilian taxpayer who bears much of the "painful sacrifice." The 15 percent tax rebates or bounties that are paid to exporters are semi-officially estimated to cost the Treasury $1 billion this year. Brazil is probably spending another $1 billion subsidizing credits and other gifts to exporters, including the Befiex system, through which multinationals get rebates that are *double* the taxes they pay on their exports. All this, of course, diverts government revenues from public investments and has caused an inflationary increase in government internal indebtedness by 56 percent in real terms (after discounting inflation) since the beginning of the year, according to the central bank.

Export and die

How can Brazil keep up 20 percent annual export growth in a recession-struck world market? A New York bank officer answered, "They now have only 1.5 percent of world exports, and they are well-placed to increase that—to the disadvantage of smaller less-devel-

oped countries." Finance Minister Galvêas answered the same question when asked on Oct. 2, "We have the comparative advantage in the cost of our labor force, which will give us the basis for competing in the international market for the rest of this decade."

Labor policy is key to Brazil's strategy. The minimum wage oscillates between $110 and $78 per month, as each increase is eroded by inflation. Industrial labor earns more, but is subject to recycling at lower wage rates. That is occurring in a dramatic way this year. Industrial employment dropped by 14 percent between last November and this September in São Paulo, with the elimination of 280,000 jobs. Some of that labor elite displaces lower-skilled workers from remaining construction jobs, receiving a minimum wage or less. The Getúlio Vargas Foundation reports an increase of 14.4 percent in the number of São Paulo workers employed full-time at less than minimum wage since the mass layoffs began last December.

The intended correlate of income reduction has been a drop in personal consumption, which has contributed to improving the trade balance in items such as food. Meat consumption is down by 25 percent and milk by 30 percent, according to the supermarkets' association. Brazil has stopped importing and begun exporting these high-protein foods. In Brazil, a third of the population was already chronically undernourished.

This is the Brazil which U.S. Treasury Secretary Donald Regan advocated should be "graduated" from eligibility for moderate-interest international loans, to going "to the market" and bearing the burden of Volcker's interest-rate levels to roll over its debts. This is the Brazil which President Reagan said at the IMF meeting must "believe in the magic of the market-place" and put "its own financial and economic house in order" through greater restraint on consumption and investment to satisfy the money markets.

Responses from Brazilian government, military, and private sector leaders were immediate, and often unprintable. Their anger stemmed not only from the explicit Reagan recommendations that Brazil be denied the $844 million in the moderate-interest loans it uses to pay debt service to the World Bank, but also from the monetarist principle that the more successful developing countries be cut loose from all the special opportunities they desperately need to keep their heads above water in a Volcker-shocked world.

Brazilian Exporters Association President Laerte Setubal, long one of the most vociferous advocates in Brazil of "free market" ideology, gave a remarkable speech Oct. 1 in answer to Reagan. "Reagan threw a bucket of cold water on the countries of the Third World," he remonstrated. "This is the historical moment in which we should, without any hegemonic pretensions, take leadership of the developing nations to deliver a dignified and vehement reaction to unilateral positions which could pull down the world economy."

Figure 3
Brazil's balance of payments
(billions of current dollars)

	1978	1979	1980	1981	1982
Trade balance	−$1.0	−$2.7	−$2.8	+$0.6	+$1.5
Exports	12.7	15.2	20.1	23.7	27.1
Manufactures	5.1	6.7	9.0	11.6	15.0
Imports	−13.6	−19.9	−22.9	−23.1	−25.5
Oil	−4.2	−6.4	−9.8	−10.5	−11.0
Service account	−4.9	−7.8	−9.5	−12.4	−11.8
Interest on debt (net)	−2.7	−5.3	−5.9	−8.2	−7.6*
Current account	−5.9	−10.5	−12.1	−12.0	−10.3
Capital movement	9.8	7.7	9.3	9.4	9.3
Loans and investment inflow	14.9	14.1	16.3	17.5	18.8
Amortizations	−5.2	−6.4	−7.0	−7.9	−9.2
Total debt service	−7.1	−11.7	−12.9	−16.1	−16.8
Debt service as a percent of exports	**62.1%**	**77.0%**	**64.2%**	**67.9%**	**62.0%**

Figures for 1978-80 are from the Central Bank. Figures for 1981 and 1982 are projections made by a major American bank in October 1981. *EIR* finds them reasonable except for their assumption that interest rates will be 2 to 3 percent lower next year, reflected in projection of reduced interest payments, marked by asterisk.