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Two years of Collor's program bring the Brazilian economy to its knees

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As the administration of Brazil's President Fernando Collor de Mello celebrated its second anniversary in power in March, the country was experiencing the deepest industrial collapse in its history, a measure of the destruction of the economy brought on by Collor's economic program. Submerged in institutional chaos, Brazil is threatened by a process of social disintegration that even has the potential to lead to territorial disintegration.

This outcome is not the result of unintentional errors, or a bad administration, or an incompetent cabinet. The destruction of national economic infrastructure and technological capability, and the dismantling of entire industrial sectors, especially the capital goods sector, is the intended consequence of following the policies laid down by the Anglo-American oligarchy. These policies are intended to permit the country's "reinsertion" into the international financial community, a process interrupted by the unilateral debt moratorium decreed by then-Finance Minister Dilson Funaro in 1987.

This intent has been manifest since Collor took office in March 1990. His administration's economic policy has been based on a very few axioms: the battle against inflation, the elimination of the public deficit, trade liberalization, privatizing state sector companies, plus the application of alien "conditionalities" imposed by the Anglo-American establishment and its banks, under the illusion that by satisfying them, the country could return to the private financial markets, based on reaching prior accords with the International Monetary Fund (IMF) and the Paris Club of creditor governments.

The chronic problem of inflation

After President Collor's surprising victory in the November 1989 elections—due almost entirely to the overwhelming support for him in the mass media, especially from the *O Globo* television network, controlled by Robert Marinho, Brazil's most powerful private citizen—his first act of government was the freezing of $80 billion worth of the savings of the Brazilian people.

The radical measure, similar to what Stalin did in 1947 to erase Soviet state debts, was supposed "to murder in a single thrust the tiger of inflation," in Collor's own words. The measure not only froze funds, but was supposed to reduce the immense internal debt, especially government notes circulating in the highly speculative "overnight" market.

Collor, so enamored of his own rashness that he enjoyed being called Indiana Jones, promised that at the end of 18 months, the frozen funds would be returned in the form of bonds during the subsequent 13 months. Although the measure artificially and momentarily reduced the rate of inflation for three months, the absolute shortage of currency, combined with very high interest rates, led to the firing of 110,000 industrial workers in São Paulo state alone during those three months, and a 10% decline in overall industrial output as of the end of last year.

But for all of this damage, the measure failed utterly to contain inflation beyond three months. By July 1990, it had jumped to 14% a month, and by December, was back up to 20% a month. This forced then-Economy Minister Zelia Cardoso de Mello to adopt a price freeze that again artificially reduced inflation for another three months, to about 7-8% a month, once again causing large-scale layoffs and a deepening depression. Overall, as a result of this policy, the average wage fell 19.7% in real terms in 1990, while the overall wage bill of the formal sector fell 24.4%, reflecting the effect of both the lowered average wage and reduced employment levels.

When scandal forced Cardoso to resign last summer, she was replaced by Ambassador to the United States Marcilio Marques Moreira, a banker tied to the Anglo-American oligarchy. His appointment signaled the return of more orthodox, monetarist techniques of managing the economy, more in harmony with the preferences of Wall Street and the other international money centers. In October 1991, without fanfare, the new minister delivered an economic shock with two new measures, a 15% devaluation of the currency, on top of the already existing daily devaluation, and the imposition of extremely high interest rates, set through the preferential rate offered by the Central Bank in auctions of government securities. This rate had been fluctuating between 2% and

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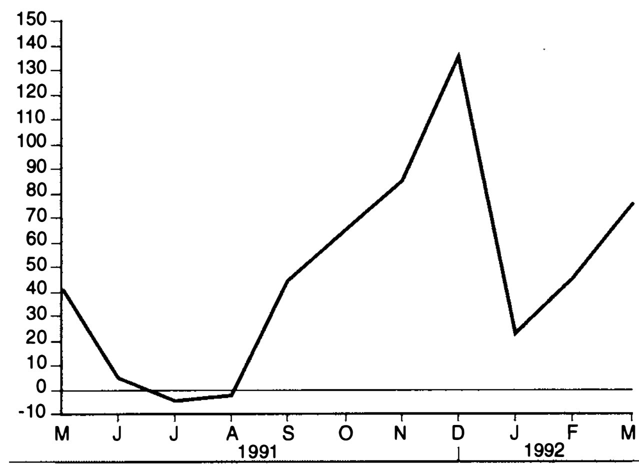
FIGURE 1
Real interest rates 1991
(annualized monthly interest rate, %)



Source: Central Bank and Getulio Vargas Foundation.

3% a month in real terms (that is, after discounting for inflation), and, in 1990, even became negative for a few months when the funds were frozen.

The rate shot up to 6-8% a month at the end of October, and hit 13% a month in the middle of December. While the rate in January fell to a monthly rate equivalent to 23% on an annualized basis (see **Figure 1**), by March, the interest rate was back up to 75.5% on an annual basis.

The stated reason that the central bank chose for raising the interest rates, a measure torn from the monetarist recipe book, was that it was supposed to sop up the surplus monetary reserves that were being released as the frozen accounts were finally unfrozen. The "great success" of Marques Moreira's measure is indicated by the fact that inflation has "stabilized" at 25% a month.

But this monetary policy has, together with other factors, had another adverse effect. The extremely high domestic interest rates, coupled with the fall in U.S. interest rates and the opening of the stock market to easy ingress of foreign capital, has led to the inflow in just the last two months of approximately $7 billion. The origin of these dollars is varied: returning flight capital, the proceeds of drug trafficking, speculative investments of U.S. investors, etc., all seeking easy profits. This inflow has forced Brazil to print huge volumes of its own currency, the cruzeiro, in the process reducing to nonsense one of the most precious goals of the "quantity theory of money" doctrines of the monetarists which minister-banker Marcilio Marques Moreira is committed to so faithfully following—holding down the money supply.

Thus, the consequence of this policy of absurdly high interest rates, supposedly intended to hold down the money supply in order to control inflation, is precisely the opposite. Every dollar that comes into the country must be monetized—turned into cruzeiros—before it can be spent or invested. By attracting this mass influx of dollars, the high interest rate policy has forced the government to print billions of dollars worth of cruzeiros, most of it in the form of new domestic government debt. But it was precisely the elimination of this enormous debt overhang that was the prime objective of the Collor policy, by means of the freeze on bank deposits.

So now, the government finds itself rapidly reaccumulating just the sort of domestic debt it supposedly is most opposed to. Between December 1991 and January of this year, domestic debt rose from 1.8% of GNP to 2.9%. And at the end of February, in just a few days, the government sold government paper worth 17 trillion cruzeiros, or about $11 billion.

This phenomenon proves the stupidity of the monetarist theories and the absurdity of the monetary policy of the Collor government. Two years ago, at the end of the José Sarney administration, 45% of all financial saving was in the form of public debt. The freezing of funds knocked this percentage down to 10.5%. As these funds started to be returned to their owners after 18 months, the problem of domestic debt has returned with greater fury, fueled by the influx of highly speculative dollars, with inflation anything but licked and compounded by the effects of the deepest economic depression in the history of Brazil.

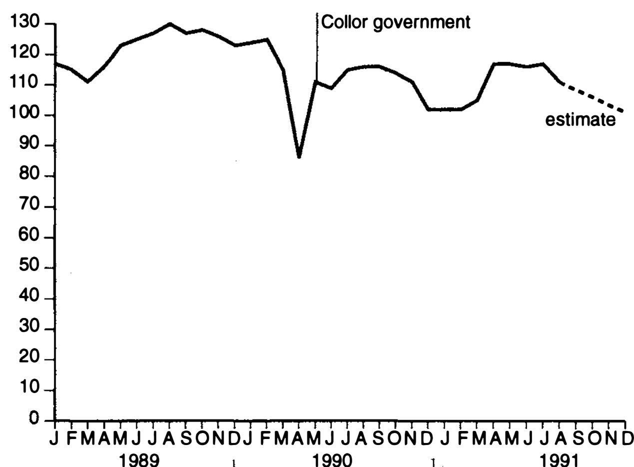
Another effect of the uncontrolled inflow of foreign dollars has been to raise the foreign exchange reserves to an all-time high of $13.5 billion, which increase is now being used as a major argument by the Paris Club to demand that Brazil pay an immediate $4 billion in interest owed the member nations of the club.

The collapse of industry and employment

If the noxious effect of high interest rates weren't enough, industrial activities have further suffered the combined effects of two other policies. First is the arbitrary suspension of public sector investments, especially the purchases by state companies from the private sector, a policy whose effects can be seen in stark relief in the plummeting of capital goods production (see below). Second is the liberalization of imports brought on by the lowering of import tariffs, exposing national industry to a savage competition, which has led to an increase only of bankruptcies, now running at a higher rate than during the economic crisis of 1981-83.

This new policy of opening up imports, which the government calls "modernization," has had the evident effect of legalizing smuggling, which is now carried on in the main cities of the country by an army of underemployed who comprise what is euphemistically called the "informal economy." This sector contributes absolutely nothing to the tax base of the country, and yet it constitutes, according to various estimates, around 50% of the national economy.

FIGURE 2
Monthly industrial production, 1989-92
(index 1981=100)



Source: IBGE (Brazilian Institute of Geography and Economics)

Although official GNP figures do not show the full dimensions of the crisis, in 1990, GNP fell 4.6%, and in 1991, it showed a nominal 1.2% increase. Industrial production fell 10% in 1990, and was flat in 1991. As shown in **Figure 2,** industrial production at the end of 1990 had fallen back to the level of 1981, and after a few months of increase, is again heading back to that level.

As a consequence of the overall policy, the industrial heartland of the country, the São Paulo region, has eliminated 434,825 industrial jobs, which implies that at least 1 million additional workers in the service sector also lost their jobs. And this process of firings has not stopped, as another 51,190 industrial workers were laid off in the São Paulo region in the first two months of 1992 alone. According to the São Paulo Industrialists Federation (FIESP), the industrial work force of the state is now 23.15% smaller than that in December 1980. According to the Brazilian Institute of Geography and Statistics (IGBE), the government statistics agency, total employment in 1991 declined 10.2% compared to 1990, the greatest fall in the last 20 years.

In sum, the present policy is perverse. Domestic industry, subject to very high interest rates, foreign competition, and the reduction of public investment, is operating at well below capacity, causing productivity losses and a consequent increase in costs, at the same time as unemployment is growing. In the main cities live millions of unemployed, many without even a roof over their heads, and millions of abandoned children, an explosive mix that has created an incidence of crime that could well be called "an informal civil war."

The government, not content with the level of industrial destruction already wrought, wants to accelerate the timetable of tariff reductions on imports, at the same time as it is banking on the prospects of a superharvest in the agricultural sector, particularly in cash crops for export. The country is rapidly returning to the colonial status it enjoyed until 1930, of being a mere exporter of primary products, faithfully following the imported English liberal doctrine that the nation's destiny "is eminently agricultural."

To be sure, the government's strategy has been molded in the illusion that the country could repeat the policies of Finance Minister Delfim Neto at the beginning of the 1980s, and generate a huge export surplus with which to punctually pay interest on the foreign debt. In 1984, while world trade grew 8.9%, Brazilian exports rose 23.3%. Delfim Neto's policies, responsible in large measure for the economic crisis now plaguing the country, appeared to work only because of the extraordinary growth of the Brazilian economy in the 1970s, especially of its physical infrastructure.

Now the effort to blindly implement the same policy, after the country has passed through the 1980s and witnessed the destruction of its physical economic infrastructure and its capital goods sectors, which have led to a reduction in productivity of the economy in general compared to the early 1980s, is doomed to failure. The only way that Finance Minister Marcilio Marques Moreira's scheme could function even for a while, would be by making exports competitive through a policy of reducing the real value of wages, on the model of Nazi Economics Minister Hjalmar Schacht.

The government at the end of its rope

The effects of the economic policy on the finances of the state are no less perverse. At the same time that the source of tax revenues—wages, salaries, fees for professionals, and business profits—are shrinking because of layoffs and bankruptcies, putting increased pressure on the public deficit, the marginal sectors of the economy, which pay no taxes, are increasing like a cancer.

Thus, the more the government reduces its economic investments, slashes personnel, sells its main state companies in areas such as steel, communications, transportation, and energy—over the resistance of nationalist political and military figures—the more the fiscal deficit increases, compounded by the deepening of the economic collapse and the growth of the domestic government debt.

According to the National Treasury, tax receipts fell by a dramatic 21% in 1991 from 1990. And the decline is continuing, with receipts so far in January-February 1992 another 18% below the levels of 1991. And at the same time, the cost of servicing the new public debt has risen by 900% over that of the first two months of last year.

According to stories appearing in the Brazilian press, technicians from the Economics Ministry are rapidly recalculating the national budget, reducing it from the originally estimated 25 trillion cruzeiros to 16 trillion. The idiocy of the government's determination to fulfill the terms of the

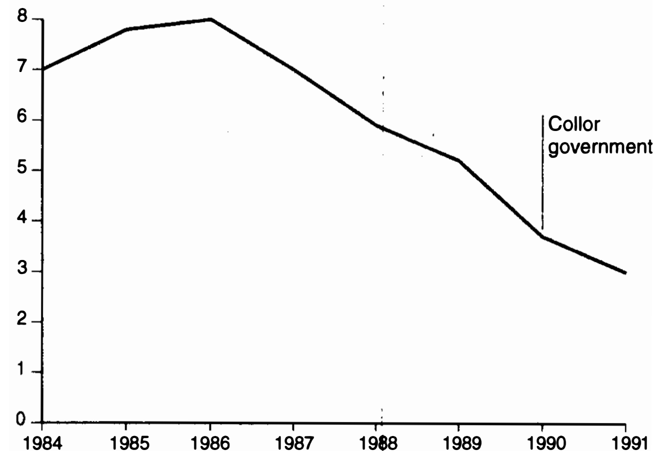
letter of intent it signed with the IMF is nowhere better shown than in its intention to lower expenditures and investments of the state down to the new levels of tax receipts, a policy certain to initiate a new, destructive downward cycle in the economy.

Parallel to this, the government is issuing $5 billion a month in new debt paper, which threatens to blow out the "fiscal adjustment" agreed with the IMF, along with the promised surplus in the public sector of 3% of GNP which is part of the letter of intent with the IMF.

The willingness of President Collor and Economics Minister Marques Moreira to accept the demands of the international financial institutions concerning the opening up of the economy and the reduction in the public deficit, based on eliminating investments, cutting costs, and privatizing state companies, was rewarded with a preliminary accord with the IMF, by which, over two years, the Fund would lend $2 billion—subject to the success of the "fiscal adjustment." Collor also made a draconian accord with the Paris Club. In exchange for refinancing $11 billion, Brazil agreed to pay the Paris Club $4 billion in interest arrears by August 1993. This means that, together with other commitments, Brazil will pay a total of $11 billion only in 1992—the highest level the country has paid since 1986.

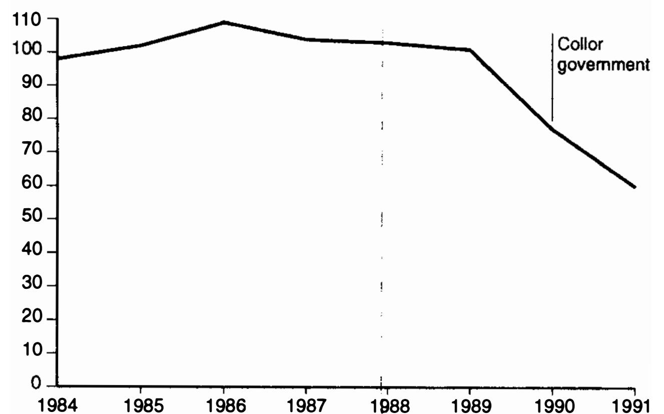
Despite the ostensible backing of U.S. authorities for Marques Moreira and his monetarist policy, as shown during the visit of U.S. Treasury Undersecretary David Mulford on March 12, Brazil is not far from a social explosion on the model of Venezuela, where a recent coup attempt by a nationalist faction of the military garnered very broad support from a population utterly disillusioned with the IMF-dictated program of President Carlos Andrés Pérez, backed though he was by the "international financial community."

FIGURE 3
Capital goods production, 1984-91
(billions of dollars)



Source: ABDIB (Brazilian Association for the Development of Basic Industry).

FIGURE 4
Employment in heavy industry capital goods sector, 1984-91
(thousands of employees)



Source: ABDIB.

Case study: The destruction of the capital goods industry

Nowhere is the devastation wrought by a succession of failed economic policies, culminating in that of President Collor, more in evidence than in the critical heavy capital goods sector of the country, which has suffered the havoc of the economic idiocies of Collor and his successive economics ministers. In 1990, when the GNP officially declined by 4.6% and the overall output of industry fell by 10%, the volume of business of the heavy industry sector of the capital goods industry, as measured in total yearly invoicings, fell 30%, while employment in the sector declined 20%.

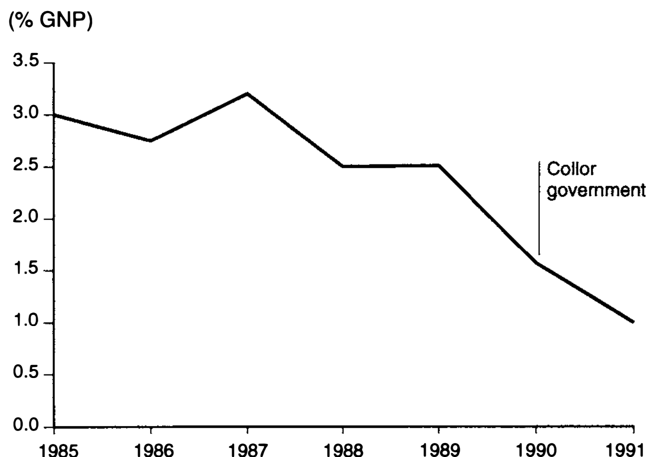
In 1991, according to preliminary estimates, orders fell off an additional 24%, declining to the level of $3 billion, the lowest level since 1974, as shown in **Figure 3,** based on information from the Brazilian Association for the Development of Basic Industries (ABDIB).

Figure 4 shows the number of employees in the same industry, which has been falling steadily since 1986, and dramatically since 1989. This signifies the deactivation of entire factories, a total disaster for a sector upon which industrial recovery depends. In 1991, the number of employees in the industry was estimated at 60,000, the lowest level since

FIGURE 5

Investment in federal state sector companies, 1985-91

(% GNP)



Source: Central Bank.

FIGURE 6

Direct investment in Petrobras, 1984-91

(billions of 1990 dollars)

Source: Petrobras.

1972, and half the number of workers in the industry in 1980. The engineering sector, closely tied to the capital goods sector, shows a similar rate of decline, having lost 22% of its work force, or 53,000 engineers and technicians, in 1990 alone.

This calamitous state of affairs is further shown in the figure for fixed capital formation, which measures all forms of capital goods, machinery, equipment, and civil construction, which fell, in real terms, to 15.7% of GNP, its lowest level in modern Brazilian history. A major portion of this decline was registered by state enterprises, whose investment level, as a percentage of GNP, fell from 2.5% in 1989 to 1.6% in 1990, and to 1% in 1991, as shown in **Figure 5.** Another factor determining this decline was the reduction by more than 25% in the investment budget of the National Bank for Economic and Social Development (BNDES).

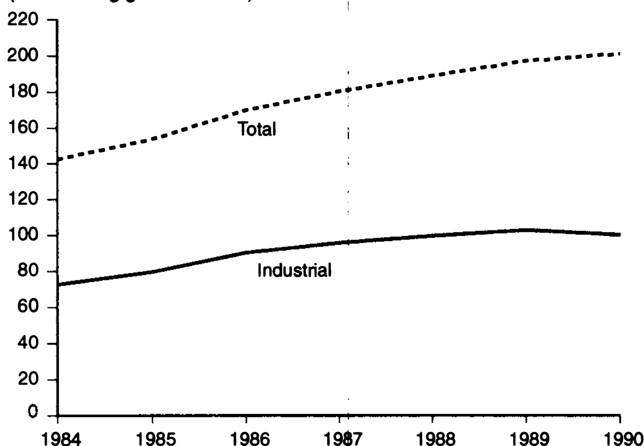
Figure 6 shows the decline in direct investment in Petrobras, the national petroleum company that contributed the most to the development of the heavy capital goods sector. In 1990, investment in Petrobras fell to $1.86 billion, an extremely low level compared to the $7.53 billion registered in 1982. It is estimated that only $1.5 billion was invested in 1991.

Collor's economic policies have also achieved another "first," of dubious merit, namely, the first annual decline in the quantity of electricity consumed in the industrial sector in the history of the country. As shown in **Figure 7,** total electricity consumption grew by only 1.9% in 1990, the lowest annual increase in Brazilian history, while industrial consumption fell 2.5%. By contrast, electricity use grew 10.6% in 1986. With investment in the electrical sector at its lowest

FIGURE 7

Consumption of electrical energy, 1984-90

(thousand gigawatt hours)

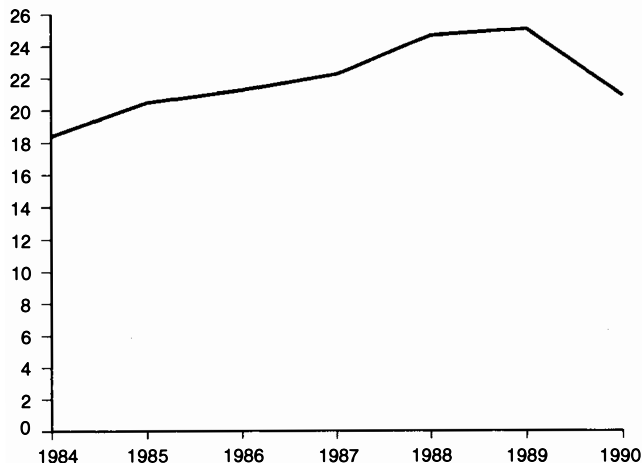


Source: Electrobras.

relative level in the history of the country, it is forecast that when and if the country tries to grow again, the monetarist policies of the past decade, greatly aggravated in the last two years, will impose an absolute barrier in the form of inadequate electrical generating capacity, that will inhibit growth for at least a decade until investment in this industry can catch up with demand.

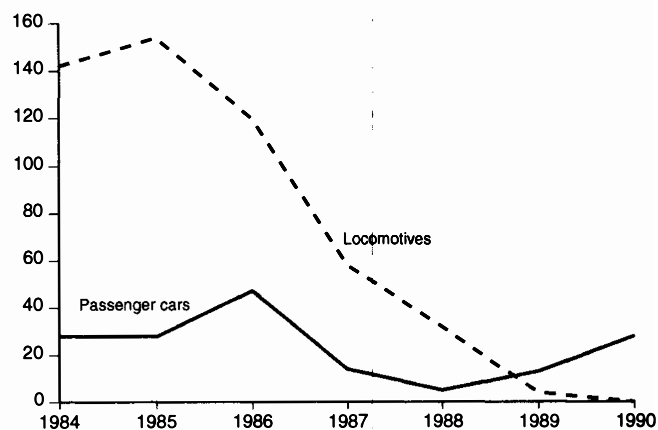
The same thing has occurred in the steel industry. As shown in **Figure 8,** steel production fell 17.9% in 1990, after

FIGURE 8
Steel production, 1984-91
(millions of tons)



Source: Brazilian Steel Institute.

FIGURE 10
Production of locomotives and passenger cars, 1984-90
(number)



Source: ABDIB.

FIGURE 9
Production of railroad freight cars, 1984-90
(freight cars)

Source: ABDIB.

FIGURE 11
Shipbuilding industry, 1984-90
(thousands of gross weight tons)

Source: ABDIB.

years of uninterrupted growth had brought Brazil to the level of output of most European countries.

The production of rolling stock and locomotives offers another illustration of the collapse of this sector. With a capacity to produce 9,000 freight cars, 800 passenger cars, and 200 locomotives, output has fallen as of 1990 to 86 freight cars, zero passenger cars, and 28 locomotives, as shown in **Figures 9** and **10.**

The shipbuilding industry reveals the same profile. In a sector that produced ships totaling 1,235,530 gross weight tons in 1978, output in 1990 fell to 151,685 gross weight tons (see **Figure 11**).

In sum, what has happened to the most developed industry of its type south of the Rio Grande and which would be crucial for any Ibero-American development effort in the coming years—is proof that the true content of Collor's economic program is the destruction of Brazil's manufacturing industry and employment.