Report from Rio by Lorenzo Carrasco Bazúa

Shadow of Mexico looms over Brazil

Brazilian reserves dropped by 25% since January, turning the government's boasting into desperation.

The insistence of President Fernando Henrique Cardoso and his economic team in marking Brazil's differences from the Mexican crisis, is directly proportional to the speed with which the Brazilian situation is every day looking more like the Mexican one. The administration's vaunting of $40 billion in foreign reserves at the outset of the year, which led them to believe they were immune to any international crisis, turned into despair, as they noted, only one quarter later, a loss of 25% in the reserves, now down to below $30 billion, with clear signs of greater losses in the short term.

The growing trade and balance of payments deficits due to capital flight out of financial markets, which had already forced the government to devalue its currency, the real, by 10% in early March, has now forced it to make a desperate U-turn in the policy of trade liberalization, raising from 20 to 70% the tariffs on auto imports and dozens of durable consumer goods which were flooding the country, endangering the very existence of national industry and millions of jobs. Although the government insists that the measure is temporary—it will only last one year, they say—the fact of having taken it is a hard blow to the trade opening launched five years ago under President Fernando Collor de Mello.

But this measure, positive in itself, does not change the government's program for dissolving the basic structure of the state and its productive enterprises, such as Vale de Rio Doce, a producer of iron ore, which it is still planning to privatize, under the illusion that foreign investment will flood Brazil, resolving the balance of payments problem. With these assumptions, it will be incapable of defending the economy from the speculative pounding, which in turn reflects the world financial crisis.

Raising tariffs could reverse the trade deficit—projected at $2 billion just in the first quarter—but will do nothing to stanch the financial bloodletting. For example, in March, the amount of capital leaving the country was $4.371 billion, whereas only $329.8 million came in, leaving a net loss of $4.041 billion. For the quarter as a whole, the exit of capital reached $14.540 billion against $6.822 billion entering, leaving a $7.710 billion gap. Most of this left after the March 6 devaluation.

To keep the loss from showing up on the books as even larger, the government used the ruse of stalling on payment of the $1.3 billion in interest due in March on its foreign debt which would shown up as a net flight of resources in the order of $9 billion in the first quarter. That, according to the government, could have led to a worse panic in the capital markets. With this move, the government claims to "dilute the impact of the flight of resources in the coming months," a source in the central bank told the newspaper *Gazeta Mercantil*.

Reality is that Brazil has to pay abroad this year $24 billion in interest on foreign debt, royalties, dividends, freight, Eurobond maturities, and payments to international organizations. To counterbalance this outflow, the government hopes to take in $7 billion—$4 billion in foreign investment and $3 billion from residents outside Brazil—which would leave the net loss around $17 billion. With the new trade measures, the government is trying to create a surplus of more than $5 billion, by trying to reduce the loss in currency to $10-12 billion, placing the reserves at around $20 billion. But this scenario will be hard to play out, mainly because a positive balance of foreign investment cannot be counted on. Indeed, the volume of flight in the speculative capital in the stock markets could grow.

But the similarity to the Mexican situation before the collapse on Dec. 20, 1994 does not end there. The government, in the illusion of stemming capital flight, is raising the interest rates at which it negotiates its paper on the local markets at the same time it is offering exchange guarantees on this paper. For example, it is trying to place $12 billion in National Treasury Letters indexed to Dollars (LTN-D), the same idiocy which was implemented by the Carlos Salinas de Gortari government last year in Mexico, when it launched the Tesobonos scheme which ended up bankrupting Mexico.

To avoid bankruptcy, the government must not try to generate trade surpluses based on reducing internal consumption. Rather, it should focus on containing the gigantic financial bloodletting due to the service on internal and external debt.

The President must recognize the error he made when, as a senator, he mobilized against the debt moratorium decreed by Finance Minister Dilson Funaro in February 1987, alleging that this would isolate Brazil from international capital flows. In other words, he will have to recognize that his government program based on those assumptions is nothing but a dream which died before his first 100 days in office were out. The specter of the foreign debt is back.

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