

Brazilian government makes a death pact with the banks

by Lorenzo Carrasco Bazúa

Less than three months after it intervened in Banco Economico to prevent its bankruptcy, Brazil's Central Bank had to act again, on Nov. 20, this time to force Brazil's seventh-largest bank, Banco Nacional, to sell the healthy part of its assets to Unibanco, while the Central Bank itself will cover the bank's bad debts. Unibanco paid \$1.04 billion to acquire Banco Nacional's retail and international operations, and, with the acquisition, becomes one of Brazil's three largest private banks.

Once again the government of Fernando Henrique Cardoso has acted to patch over the state of bankruptcy of the country's national financial system. Despite efforts by Central Bank President Gustavo Loyola and Finance Minister Pedro Malan to minimize and suppress knowledge of this crisis, it has reared its ugly head. Nacional's exact losses have not yet been revealed, and according to Brazilian banking analysts, this is what the financial markets want to know. The Nov. 23 *Tribuna da Imprensa* warned that the "rotten" debts of one bank are a good indicator of the distribution of risk throughout the entire system, and if the figure for Nacional's bad debt is high, this would exacerbate the crisis of the system as a whole.

Nor is the crisis in Brazil's banking sector an isolated case. The bankruptcy of the international monetary system has rocked the economies and banking systems of most Ibero-American nations. Argentina's banking system has never recovered from the Mexican devaluation crisis of December 1994, after which it lost almost \$8 billion in deposits—which have yet to return. While the Carlos Menem government has resorted to an array of rescue measures, the system remains extremely fragile. The Mexican banking crisis is even more severe than Argentina's, and the Ernesto Zedillo government has had to enact several emergency measures in an attempt to keep the banks afloat.

Banco Nacional was founded 51 years ago by José de Magalhaes Pinto, a powerful politician and governor of Minas Gerais state. He was known as the civilian commander of the military movement which overthrew President João Goulart in 1964. Banco Nacional's problems became particularly thorny for President Cardoso, due to family involvement: his daughter-in-law, Magalhaes Pinto's granddaughter-

ter, held 17% of the bank's stock.

To finagle the sale of Banco Nacional, the government financed a \$1 billion loan at super-subsidized rates; but this is a small part of the bank's estimated \$4 billion in losses. The loan was made possible because of a law which the federal government itself imposed on the Congress, under the pompous title of Program to Stimulate the Restructuring and Strengthening of the National Financial System (PROER). The law, which is intended to promote bank mergers, was adopted after the direct intervention of the Federal Reserve Bank of New York.

In fact, the PROER doesn't even begin to cover up the rather perverse relationship which President Cardoso maintains with the leading national and international bankers, who dominate every aspect of national life. As *Veja* magazine reported on Nov. 22, an anonymous minister of State said that "Nacional won't go under because it can't. If this happens, others will go down with it. This is a government decision." This idea of rescuing bankrupt banks by any means possible was the most relevant aspect of talks that took place between Mexican President Zedillo and President Fernando H. Cardoso, during the October summit of Ibero-American heads of State in Bariloche, Argentina.

The essence of this relationship is based on the promiscuity which has existed between Brazil's public finances and the private financial system, to the point in which several of the private banks' leading executives came from the Central Bank's board of directors. The government can't let the banks collapse, because it assumes that with them, the entire structure of internal public financing would also collapse. With this logic, and according to its own monetarist dogmas, the government can also set usurious interest rates at astronomical levels, which the banks will agree to impose on the economy as a whole. It is this insane relationship which, so far, has made it possible to maintain so-called monetary stability—despite the destruction of Brazil's physical economy.

Why the financial system is a wreck

Monetary authorities claim that the banking system is in a phase of "accommodation," due to the reduction of inflation,

which had been the source of the financial system's gigantic profits. While there is some truth to this, it by no means explains the banking system's real difficulties.

The system is in bankruptcy because the physical economy at all levels is in bankruptcy. It is not only that thousands of industrial and agricultural enterprises are simultaneously ceasing to pay their debts and laying off their employees and technicians. On a mass scale, individuals are also failing to honor their personal debts with banks and businesses.

This dramatic reality is reflected in the growth of debt payment arrearages (loans more than 60 days overdue), and in non-performing debt (loans more than 180 days overdue with insufficient collateral, or 360 days overdue with sufficient collateral). According to the Central Bank's November 1995 bulletin, the total amount of debt arrearages, as of last July, was \$26 billion, an increase of 130% over July 1994 when the "Real Plan" was launched.

Of this total amount of arrears, the rural sector accounts for \$4.3 billion; industry, \$8.4 billion (an increase of 150% in one year); business, \$3.3 billion (an increase of 300%); and personal arrearages, \$2.2 billion (an increase of 500% compared to July 1994). All together, the level of non-payment represents 12% of all credits granted by the financial system to the private sector. Although Central Bank figures aren't available for subsequent months, the pattern of non-payment continues to grow, placing the entire banking system in jeopardy.

A former justice minister and former Supreme Court magistrate, Paulo Brossard, characterized the PROER in his column in *Pôrto Alegre's Zero Hora* on Nov. 13. He wrote that the government, already in possession of certain privileged information, authored a law and sent it "in the early hours of a Saturday before the light of day appeared on the horizon . . . to rescue the financial system, which has for so long benefitted from the usurious policies which corrupt, subvert, and destroy the work of Brazilians in agriculture, industry, and trade." Brossard continued, "Brazilian society has been whipped by official plunder, and no one benefits more from it than the financial system; and now the government comes, in the dark of night, to reward finance capital, granting it special credits as well as tax benefits."

With the crises of Banco Economico and Banco Nacional, the government has already injected over \$5 billion into the banking system. And now with PROER, it will be free to help the bankers with another \$10 billion or more, which is the minimum amount which banking analysts estimate is needed.

Usury bites its own tail

The level of arrears, on which there is little hope of future payment, is a direct result of the very dynamic of the government's monetary stabilization plan. It's worth repeating what *EIR* has reported many times before. The Real Plan is based on three monetary artifices: First, the fixing of an artificial

exchange rate which, together with the lowering of tariff barriers, allowed the country to be flooded with cheap imported products, to the detriment of national industry and agriculture. Second, the freezing of agricultural prices below the level of the minimum cost of production. And third, winning the world's usury championship, with annual interest rates of 200%, while inflation was supposedly close to zero.

The first of these policies caused a decline in economic activity, although official stupidity refuses to call this a recession, much less recognize the reality of a deep depression. The second led to a transfer of profit from the agricultural sector of at least \$15 billion, despite the largest grain harvest in Brazil's history. And the third pushed the entire economy toward the abyss, through the disproportionate growth of forced indebtedness.

With these policies, the government caused an explosive growth of indebtedness at the federal, state, and municipal levels, while the effects of monetary policy led to a drop in tax revenues. For example, internal debt in government bonds, which are negotiable within the financial system, doubled beginning in July 1994, when the Real Plan was launched. That debt was \$70.2 billion, with the federal government accounting for \$59.5 billion, and the states and municipalities accounting for \$20.6 billion. By October 1995, the amount had grown to \$140.3 billion, of which \$103.2 billion corresponded to the federal government's share, and \$37.1 billion to that of the states and municipalities.

So that the reader may have a more precise idea of what this means, the government's debt grew during this period at a rate of \$1 billion per week, and this has now increased to \$1.5 billion per week. What this means is that every working day, the debt in bonds of the federal, state, and municipal governments increases by \$300 million.

As a result of this exploding debt, through August of this year, the public sector had already spent \$20 billion in interest payments. Combined with the fiscal contraction, this caused a deficit in public accounts of \$21 billion as of September, the equivalent of 4.36% of Gross Domestic Product.

This hemorrhaging of public resources caused a current account deficit of \$13.7 billion up through September, now being financed by the enormous inflow of speculative capital. As of September, the liquid amount of foreign capital invested in Brazil was \$23.7 billion, of which \$18 billion corresponded to the third quarter alone, thus reversing the outflow of capital which occurred after the Mexican devaluation crisis of December 1994.

While it is true that the government of Fernando Henrique Cardoso will not confront a short-term exchange crisis similar to Mexico's, and that it has raised its foreign reserves to almost \$50 billion, the effects of monetary stabilization policies, particularly the usurious interest rates which attract foreign capital, are leading the entire national economy into bankruptcy. And what the government does through PROER is irrelevant.