Brazil's Cardoso: double or nothing on a losing bet

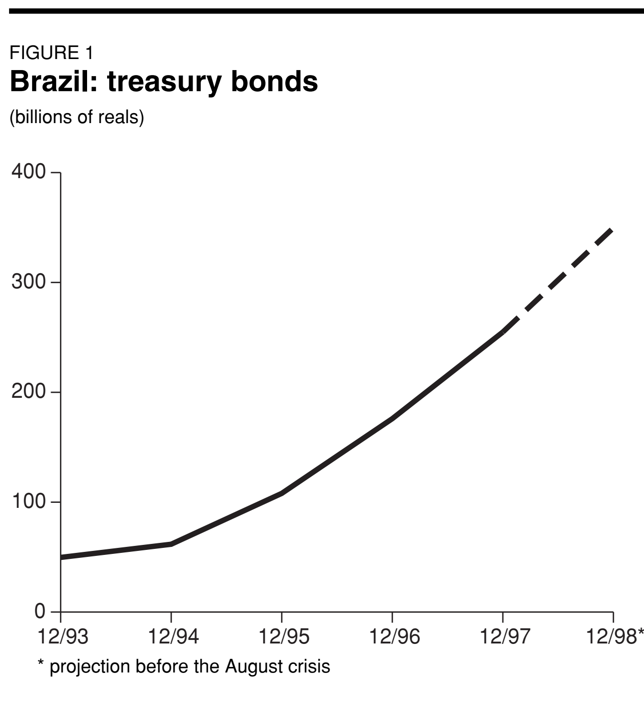
by Lorenzo Carrasco

The party, exquisitely laid out by the President for the well-to-do elite, is coming to an end. The 5,000 guests, elegantly dressed in the latest fashions from London and Paris and toasting each other with crystal glasses filled with the finest imported liquors, sampling from nearly a ton of delicately prepared shrimp, dancing and laughing to the beat of orchestral music designed to caress their enormous egos, are beginning to leave. Caravans of luxury cars drive the rich and powerful to their majestic homes. But, oh, the great shock to come! Six days later, on Nov. 15, 1889, the host of the great Fiscal Isle Ball, Emperor Pedro II, is overthrown by the Brazilian Army, and replaced by a republic.

These images which describe the extravagance of a monarchy unwittingly in its death throes, offer us an apt historic parallel to a situation which could be emerging in the short term, if the current government of President Fernando Henrique Cardoso insists on staying the course of monetary policies which have characterized the first four years of his government, a course which now requires implementation of a vicious austerity package negotiated with the International Monetary Fund (IMF) in exchange for an emergency $30 billion credit line.

In truth, that promise of aid is nothing in view of the flurry of federal paper being offered by the Cardoso government at super-high interest rates, for the purpose of satisfying the gluttonous world speculative market, even while driving public finances into bankruptcy—this, despite the gigantic increase in federal tax collection, all of which is absorbed as a tribute to usury (see **Figures 1** and **2**). Without having to lose a war, nor suffer strategic bombings, the picture that emerges in the immediate future of the Brazilian nation is nonetheless comparable. It is a picture of desolation: thousands of national companies in bankruptcy, hundreds of thousands of farmers either bankrupt or hopelessly saddled with mountains of debt, millions of laid-off workers desperately scouring the country's main cities for any jobs or joining the ranks of the starving, some of whom are being led by activists of the Landless Movement (MST) to invade properties, loot food trucks on the highways, and sow terror, as did Wallenstein's armies during the Thirty Years' War in 17th-century Europe.

FIGURE 1
Brazil: treasury bonds
(billions of reals)



* projection before the August crisis

The president of the Federation of São Paulo Industries, Horacio Lafer Piva, exclaimed: "Industries are not going to remain silent about the recession. We are frightened. They're playing double-or-nothing on a losing monetarist bet." Cardoso's initial bet, to which Lafer is perhaps referring, was the one which the President described on June 19, 1997 in the following manner: "We here are wagering that this risk [of financial collapse] is temporary."

The end of 'Monopoly' money

Despite the efforts of the communications media to suppress the truth with the most vivid government propaganda, the devastation which the President's smiling face cannot hide brings to mind a post-modern version of "The Picture of

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FIGURE 2
Brazil: tax revenues
(billions of reals)

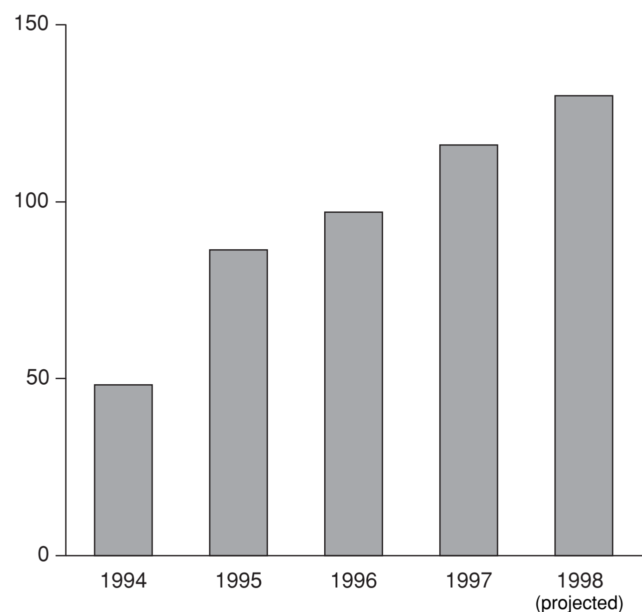
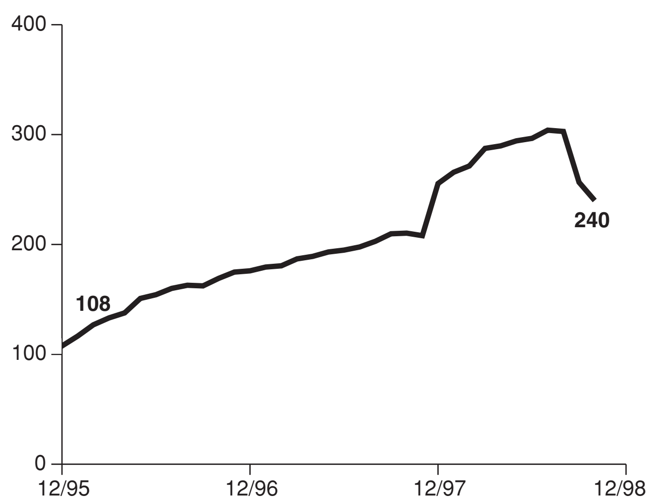


FIGURE 3
Brazil: treasury bonds
(billions of reals)



Dorian Gray": The party is over, and it's now time to pay the bill. Until now, it has been enough for the government to issue bonds at lucrative interest rates, to put the valuable patrimony of public companies up for sale, and to allow thousands of private companies to pass into foreign hands. In this way, resources have flowed to Brazil from a source which the government considered miraculous and bottomless (the accounts of international speculators), and in that way the country got the funds needed to cover the growing current account deficit, a deficit which was in part caused by the free trade policies which flooded the country with imports. It was this which led to the deceptive growth of foreign reserves at the Central Bank.

A sad end for the credit of the republic. So much "Monopoly" money has been issued in such a short period of time, that now, no one wants any. In truth, they are no longer strictly certificates and bonds; more than 90% have become documents indexed either to the dollar or to the interest rates, in a kind of temporary truce with the financial market which is awaiting, like the government, some sort of universal miracle to prevent that mountain of government paper from collapsing, and taking with it the entire national banking and financial system.

Already in August and September, when more than $30 billion in reserves left the country, the entirety of government paper suddenly shrank by 45 billion reals (the Brazilian currency), that is, by nearly $40 billion, at the current exchange rate of 1.18 reals to the dollar, simply because no one was ready to roll it over (**Figure 3**).

In the face of this, anyone in their right mind would recognize the calamity, and would prepare to immediately abandon the free-market neo-liberal monetary programs that caused the disaster. But this is not what the international bankers, nor the Cardoso government, are doing. Instead, they are still feeding the illusion that the crisis is temporary and that there is nothing else to do but wait for the still powerful nations and institutions of the world to fix everything.

Fatal tax package

The announcement of the new tax package, designed to collect more than 13 billion reals in new taxes and to slash 8.7 billion reals from the 1999 federal budget, in hope of thereby drastically reducing the fiscal deficit by more than $60 billion, is part of the insanity which radiated from the New York meetings of the IMF and the Group of Seven in early October, where a collection of panicked bankers and government officials met to discuss how to hide the volcanic eruptions of the world crisis. It was within that climate that the IMF's "aid" package to Brazil was born.

But this package is but a prelude to a far greater disaster. To stop investing in the real economy and to try to collect more taxes from an economy which, for a long time, has been plundered by usurious interest rates of 40-50% and subject to an uncontrolled economic opening, will cause a real contraction of at least 5% in next year's Gross National

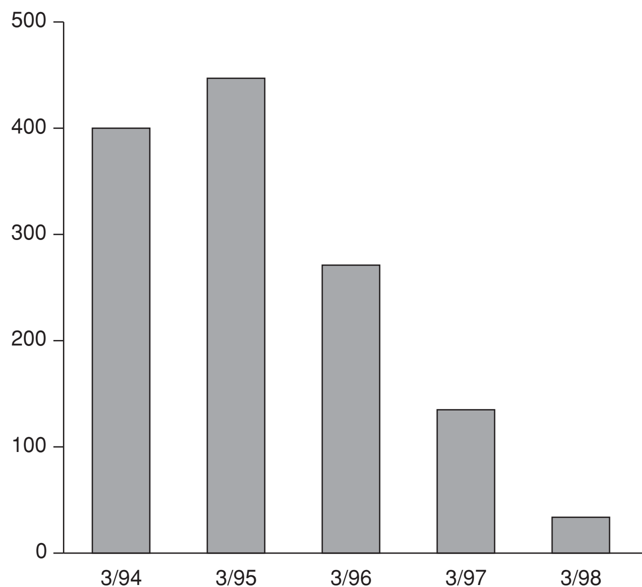


FIGURE 4
Brazil: bean reserves
(thousands of tons)

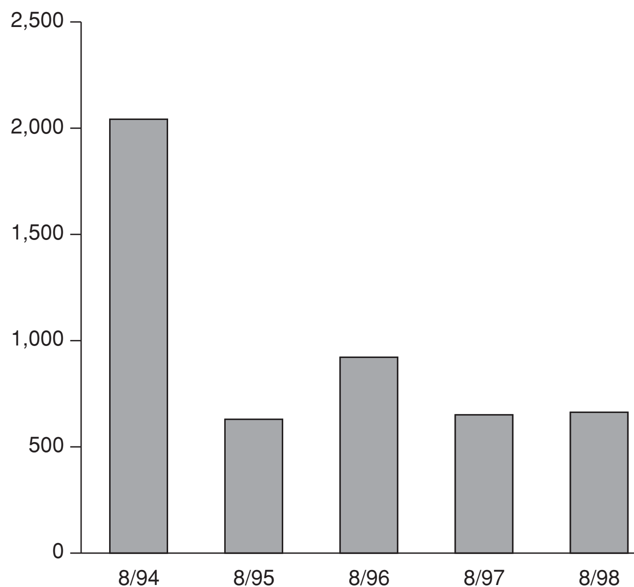


FIGURE 5
Brazil: wheat reserves
(millions of tons)

Product. At the same time, industry will shrink minimally by 20%, causing a rapid increase in unemployment in the main cities, which represents 25% of the national labor force. The financial storms of August and September have already reduced sales of automobiles and other industrial goods by 25%, and this can only get worse.

As far as agriculture is concerned, the picture is no better. Last year's mediocre grain yield of 80 million tons will be matched only with great difficulty—with the aggravating factor that the country currently holds grain reserves of less than one month's national needs, and already relies on large imports of wheat, rice, and corn, products in which Brazil was self-sufficient not long ago (**Figures 4-6**).

What is most absurd is that this terminal sacrifice will do nothing to improve the fiscal situation. Tax collection will fall because of the economic depression, and because the real cause of the fiscal deficit—growing interest payments, equivalent to $60 billion a year—remains untouched. No matter how much the government promises rapid reductions in interest rates, something which is highly improbable in any case, given the international environment, the public debt created in recent months by interest rates around 40% will not only absorb the euphemistically named "fiscal savings," but will proportionally increase with respect to the total fiscal base. Lloyds Bank predicts that, with the current public debt at 395 billion reals, a stable GNP and a 22%

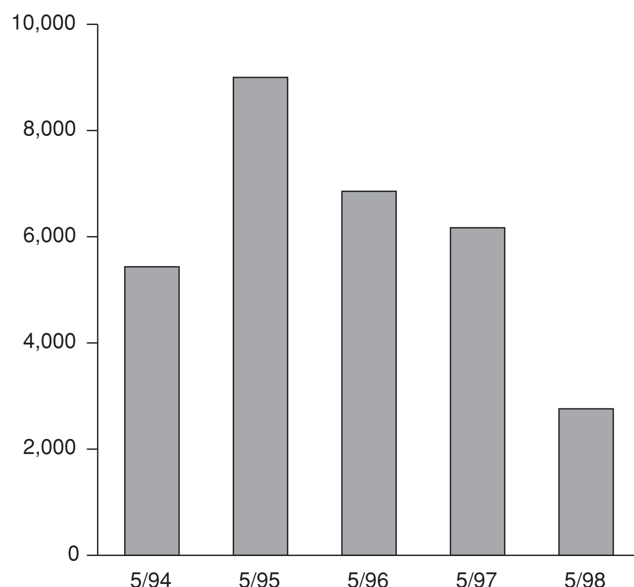


FIGURE 6
Brazil: corn reserves
(millions of tons)

interest rate next year, as proposed by the government, will still increase debt service to 73 billion reals. But if rates should fall to only 30%, debt service will cost 104 billion reals. No matter what the scenario, usurious looting will take off.

Even more serious, if GNP shrinks by 3-5% next year, industry will enter into depression and tax revenues will fall dramatically, by as much as 20 billion reals—a good deal more than the 13 billion reals that the government hopes to squeeze out of the economy with its new fiscal package, according to the calculations of former Central Bank president Thadeu de Freitas.

Chaos and crisis of the Federated Republic

Only a battery of arbitrary Presidential decrees will make possible the imposition of a fiscal package of this sort. And, it is only the dogmatically rigid neo-liberal economic team who apparently believe that the National Congress will approve the proposed measures.

- First, because of its depressive nature, broad sectors of the population fiercely oppose the package.
- Second, because the government's base of support was split by past elections.
- Third, because three of the four recently elected governors of the country's most important states are openly opposed to the government's current economic policy, and the majority of the rest will not accept the proposal to reduce resources constitutionally allocated to states and municipalities, as the fiscal package would require. On this point, we can forecast that the government's insistence on manacling the fiscal autonomy of the states and municipalities, will unleash a crisis within the Federated Republic itself, which will only aggravate the institutional crisis.

The climate of opposition to the economic package was expressed by an advertisement published in various national newspapers on Oct. 27 by the Brazilian Association of Machine Industries. Entitled "Enough Hard Blows," the document expresses indignation over the announced measures:

"For months, the nation has awaited with apprehension those measures which offer us little in the way of peace and tranquillity with regard to the future. And this has been very distressing. . . . For lack of a secure path, the productive sectors are perplexed: The . . . unfavorable picture stops sales, slows investments, and increases unemployment. Nobody wins with this except the opportunistic, nationless speculators, who have indeed benefitted from the governmental policies. . . . Clip the wings of these birds of prey and revitalize the role of the medium- and long-term investors. Brazilian companies, above all the small and medium-sized ones, are living through a dramatic time, stunned by the latest developments—brutal increases in interest rates and reduction of financing ceilings."

The association ends its unusual advertisement with a call to arms:

"Capital goods industries await the next blow. But they will not lower their guard. . . . They remain on permanent alert through their members, while they seek creative solutions that will enable them to weather the storm and confront tomorrow, despite the myopia and insensitivity of certain rulers."

"Unfortunately, the old logic of taking the easy path presages a hard blow to come: increased taxes, a foolish proposal that will cause a generalized fall in the rate of consumption, will worsen the recession and, as a result, will shrink tax revenues instead of increase them. And while we wait for the dog to bite its own tail, the measures and reforms which are necessary for us to be able to plan our business affairs, based on the security of a long-term view, are being brushed aside, with cynical arguments of the obese power of the insensitive. In view of all this, the order of the day is to fight. We are going to use every means to force the rulers to wake up, to take a bath of reality, common sense, and patriotism. . . . To accomplish this, it is urgent to formulate lasting policies for every productive sector. Watch carefully, lest another of these palliative actions causes irreparable damage. For those on their knees, the next blow could prove fatal."

Some of the recently elected governors have joined these protests. For example, a spokesman for the governor of Rio Grande do Sul, Olivio Dutra, said that "the governors will not allow themselves to be transformed into mere administrators of military policies that repress their populations made desperate by cutbacks in social areas, cutbacks imposed by the IMF and by President Fernando Henrique Cardoso." Former President Itamar Franco, recently elected governor in Minas Gerais, stated that "what is important is to stress that here in Minas, we will not allow this adjustment to bring recession and unemployment. No one is going to privatize the Electric Company of Minas Gerais while I am governor."

With resistance of this sort, it is probable that President Cardoso will be announcing such fiscal measures in full knowledge that he will not be able to easily impose them, just as occurred with the previous fiscal package in October of last year, at the height of the Asian crisis. In fact, it is possible that the tacit agreement with the bankers and with the IMF is simply to win time for his game of poker, betting that the policy of reducing the U.S. Federal Reserve rediscount rates, announced recently by Federal Reserve Chairman Alan Greenspan, will be sufficient to unblock capital flows and to avoid the bankruptcy of the major banks, especially those in the United States which are exposed in the Brazil crisis. These are vain illusions by those, such as President Cardoso, who plan on reviving the inflationary policies of Lord Keynes to try and sustain the ephemeral life of British Prime Minister Tony Blair's "Third Way," so enthusiastically supported by President Cardoso.