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Brazil's 'real' currency plan will accelerate economic bloodletting

by Lorenzo Carrasco

On July 1, the Brazilian government imposed on the country its latest monetary reform, advertised as intended to stop inflation in a single blow, but which in practice threatens to bring on a violent deflation that could lead to an economic collapse without precedent in the economic history of Brazil. There could be no more fitting homage to the Bretton Woods accord, as the respected journalist Rubens de Azevedo Lima pointed out in the Brazilian daily *Correio Braziliense,* than the fact that exactly on the 50th anniversary of that world conference which imposed the current international monetary system on the world, Brazil should decide to totally surrender its monetary sovereignty and credit-issuing power in order to adopt the use of the U.S. dollar as its own, under the guise of introducing a new monetary unit, the "real" (pronounced "ray-ahl").

In reality, the "real" monetary reform plan establishes a monetary straitjacket of the British colonial type, formerly based on a fixed gold standard, which limits the volume of circulating currency and credit to the quantity of physical reserves of dollars in the Central Bank. With this maneuver, the economic team of the cabinet, led by Finance Minister and former Ambassador to the United States Rubens Ricupero, has cut the volume of currency in circulation by 50%, from $18 billion worth of cruzeiros, the former currency, to $9.5 billion reals, equal to $9.5 billion at a one-to-one real-dollar parity, which limit is to prevail until 1995.

In the initial phase of the plan, which began on July 1, only 7.5 billion reals have so far been issued. In practice, the adoption of this plan represents the abolition of the right to issue money or credit, passing these vital functions to groups of international financial speculators who, along with the U.S. Federal Reserve System, determine the flow of resources of dollars that circulate internationally.

According to the quantity theory of money used to justify this plan, the reduction of currency in circulation below that necessary for the circulation of goods and services, which the real plan will bring about by and of itself, will impose the sought-for "monetary stability." This turns out to have the effect of up-valuing the real with respect to the dollar. Thus, in the first week after the introduction of the real, the value of the dollar fell 15% against the real to 85 centavos.

No credit for production

Reminiscent of medieval doctors who bled their patients until they were too weak to survive, a handful of monetarist doctors from the principal universities of the United States and Great Britain will administer the plan, releasing currency, drop by drop, to the National Monetary Council. Representatives of the Banco do Brasil, which has historically been responsible for the distribution of credit for the productive sectors of the economy, including for agriculture and industry, are expressly barred from this council under the new legislation.

The government is confident that the nation's dollar reserves, in excess of $35 billion, which are controlled by the Central Bank, will be sufficient to maintain the new parity of the real with the dollar. In reality, this volume of dollars is not stable and, at the first sign of any perceived instability, could flee the country in short order. Much of the funds coming in have gone toward purchase of portfolio investments which, by contract, can be converted back to dollars immediately, and then pulled out of the country.

Dollar inflows tied to public debt

The inundation of dollars actually derives from the extremely high rates of interest, an incredible 50% a year above the inflation rate, that the government guarantees for the holders of these stocks and bonds. At this usurious interest level, Brazil experienced an influx of $12.2 billion in such "investments" just from January to May of this year, which raised the reserves to their present level, at the cost of increasing public indebtedness by about $9 billion.

The direct relation between dollar inflow and public debt is due to the fact that the Central Bank is obligated to spend national currency to buy whatever dollars enter the country, offering at the same time government bonds intended to absorb the extra money thereby pumped into the economy so as not to increase monetary liquidity. This mechanism clearly demonstrates the insanity which underlies a system

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that must maintain super-high interest rates. This problem will become even more serious now, because the government has decided to raise interest rates even higher.

The artificial upvaluation of the real vis-à-vis the dollar, according to monetarist logic, will provoke a mass buying spree on the part of those who have substantial savings.

To prevent this, the interest rates are being raised again. The overnight rate was just raised by the Central Bank to 8%, which rate serves as a reference point for the entire banking and credit system, at the same time as the reserve ratio for deposits in the banking system was raised to 100%. With this measure, those who keep their reals in savings or investments can earn 4 to 5% a month, while those who try to withdraw funds from the banking system will have to pay interest rates above 10% monthly, an insane level of usury.

Deflation and hunger

This reform could bring about "monetary stability" in the short term as intended, but its effects on the circulation of physical goods and services will be disastrous: First, because it is insane to promote a reduction in consumption in a country in which 50% of the population lives in misery and 34 million are at the point of extreme hunger, verging on starvation. In 1993 alone, under the effects of previous economic "therapies," Brazil reported 530,000 cases of malaria, 5 million cases of schistosomiasis, 5 million cases of Chagas disease, 200,000 cases of leprosy, and 100,000 cases of tuberculosis. The fascist doctors who are administering this new plan are able, in the face of this, to hail the fact that in the first week of July, i.e., the first week of the new plan, consumption in the main cities of the country fell approximately 40% compared to the first week in June.

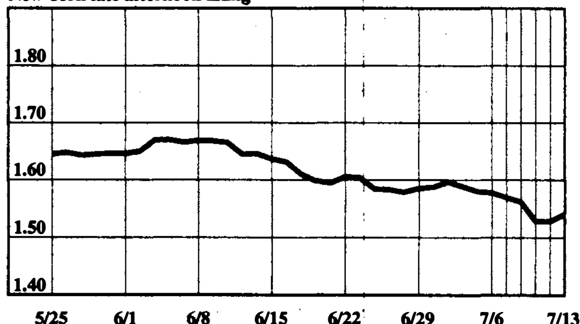
High interest rates and a precipitous fall in consumption will result in a sudden deflation, but one which will lead mainly to the bankruptcy of the small and medium-sized industries that lack the financial capacity to survive such declines, and which will feel severe price rises in the cost of their inputs. This, in turn, will quickly lead to an increase in unemployment, as layoffs will be the main means of cutting costs in an economy that is violently contracting. And there is no doubt that in the medium term, this violent deflation will provoke in its turn a decline in tax revenues that could deal a mortal blow to the already weak central government finances.

Trade and balance-of-payments deficits

The exchange rate upvaluation will, in a very few weeks, bring about a drastic decline in Brazilian exports and an increase in cheap imports that will very shortly erase the current sizable trade surplus, now running at $15 billion a year. This tendency will be encouraged further by the lowering of tariff rates and the overall program of liberal reforms being introduced. Within a few months, Brazil will join the

Currency Rates

The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
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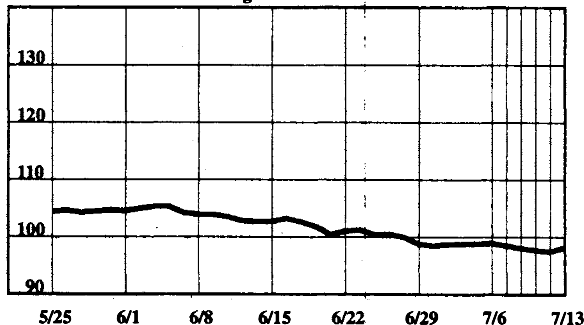

The British pound in dollars
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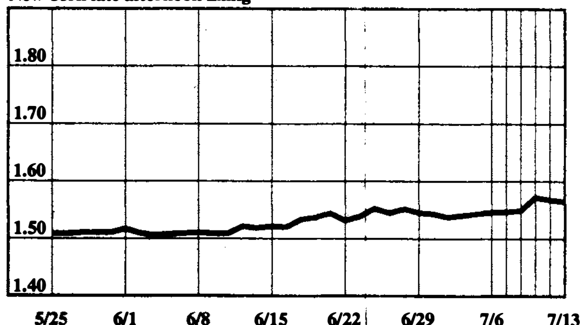

The dollar in Swiss francs
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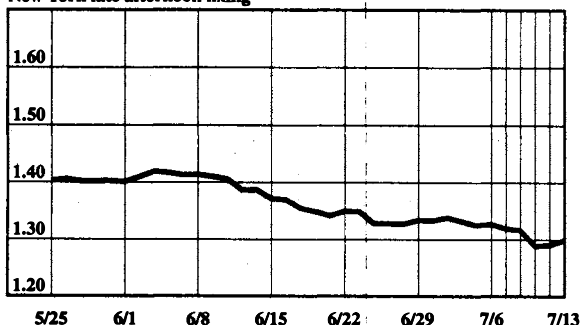

club of free trade orphans, to which Argentina and Mexico already belong, and begin racking up growing and unsustainable trade and balance-of-payments deficits.

Finally, and disastrously, this new monetary policy will provoke a huge increase in internal public debt, especially that denominated in bonds and national treasury notes. In April 1994, the debt in bonds and short-term paper totalled around $72 billion, whose refinancing was costing the government around $15 billion a year. With the increase of overnight interest rates to 8% and assuming an inflation rate of 3-4% a month, the usury "spread" will jump dramatically, which implies that the internal debt will soar correspondingly, rapidly exceeding the historical high of $100 billion. At this rate, all of the available money in the banking system will be engaged in buying bonds and government paper, eliminating all remaining credit flows to the real economy.

Public patrimony for sale

An integral part of this plan, enshrined in the Decree Law which establishes the real, establishes in Article 29 the creation of a Fund for the Amortization of the Public Debt, charged with paying off government debt by selling off the public sector industries and other assets.

By this measure, the public sector can be freely sold without the previously necessary approval of the National Congress, a provision that is *prima facie* unconstitutional. By this administrative mechanism, the public sector will be governed by a merely monetary dynamic subject to the whims of financial speculators who will manage the privatized companies with the sole aim of acquiring wealth, and not the national interest.

Even more serious is the fact that the revenue received from the sale of the national patrimony will be destined exclusively for amortizing the public debt. The absurdity of this monetarist algebra is that the estimated value of the public sector assets scheduled to be privatized is only $20 billion, little more than the amount currently being paid annually in interest on the government debt.

Politically, the purpose of the present reform is to hold things together just long enough to reach presidential election day in October without a monetary blowup. But, despite the optimism flowing from the government, it is clear that any stability achieved will not be durable, and, depending on the levels of inflation over the next three months, the program could suffer insupportable pressures and fall apart even before the elections.

Moreover, by tying itself to the U.S. dollar, itself subject to wild instabilities at the present time, at a time when the entire world financial system could blow apart any day, this program may prove to be nothing but a ticket to one of the best staterooms on the world financial *Titanic*.

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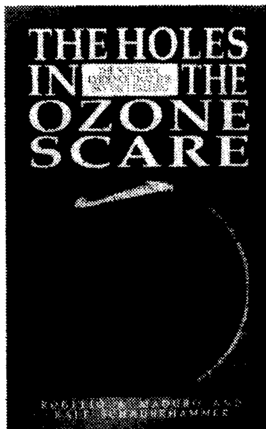

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