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## Report from Rio by Lorenzo Carrasco

# Cardoso will face money crisis

*The new Brazilian President's political base is stronger than pundits expected, but economic crisis will set his agenda.*

The incoming government of Fernando Henrique Cardoso, even before it assumes office on Jan. 1, is threatened by premature weakening from the grave problems which already confront the monetary stability plan which Cardoso drew up as treasury minister for Brazil's currency, the *real*.

That plan bought the momentary monetary stability which allowed Cardoso and his Brazilian Social Democratic Party (PSDB) to win a political base of support unprecedented for an elected Brazilian President in the Nov. 15 elections. The PSDB alone, without counting the parties allied with it, won the gubernatorial elections in São Paulo, Minas Gerais, and Rio de Janeiro, the states which contain two-thirds of all industrial and agricultural activity in Brazil.

Thus the potential for instability confronting the incoming government, does not stem from any lack of a political base in Congress, at least in the short-run, but rather from the fragility of its monetarist financial program.

According to monetarist reasoning, an excess of liquidity requires the government to keep interest rates high on government paper, which provides the reference point for the entire national banking system. By such reasoning, the overnight rate almost reached 6% a month in October, against an inflation rate of 3%. Then the economic team went on red alert.

The increase in domestic interest rates, in the context of total economic deregulation, has caused two serious short-term economic problems. First, speculative capital of every kind has flowed in to benefit from the financial carnival. Some $410 million entered the country on Nov. 8 alone. The financial derivatives market in Brazil tripled last year, reaching the fabulous sum of $1.3 trillion. Also, according to the International Finance Corp., the Brazilian stock market grew by 77% over the last year, the largest increase in all Ibero-America.

This speculative income has artificially raised the value of the Brazilian currency vis-à-vis the dollar, reaching the record level of 83¢ to the *real* in the first week in November. This, before adding in the inflation rate since the *real* monetary program was implemented last July. Thus by December, the exchange rate is projected to reach heights at which Brazil's export sector can be expected to die of massive heart attack at any moment.

To slow the rapid increase in the *real*'s value, financial authorities have had to intervene heavily in the exchange markets, buying up U.S. dollars. The country's foreign reserves have risen to over $50 billion.

The increase in interest rates has also had a devastating effect on the productive sector, driving up costs of production, and therefore prices, despite the *real* plan's commitment to freeze prices.

With their costs rising, national industry will not be able to resist for much longer the influx of goods imported at artificially low prices.

Yet the economic team insisted on penalizing credit even more, alleging that the inflation is the result of an increase in consumption by Brazilians. This policy of monetarist lunacy, in fact, promotes luxury consumption by a minuscule caste who stock their backyards with imported cars in the midst of general impoverishment.

The effect of this policy will also be felt soon in a dramatic increase of internal public debt, which is the mechanism through which speculative capital is looting the national budget. Soon, the only thing left will be the assets of public sector companies, which will be used to keep this unhappy system alive a short while longer.

In the face of this worsening economic picture, Cardoso's government will face two alternatives: To continue to cling to the fetish of an artificial and momentary monetary stability, will lead to a total dollarization of the economy, capital flight which will lead to a devaluation of the *real*, indiscriminate privatization of strategic sectors of the national economy, and the total and final opening of the economy to the speculative buzzards. Under this alternative, the country and its governing authorities can do no more than watch as Brazil becomes deindustrialized, and await the onset of the imminent world financial collapse.

If President Cardoso wishes to salvage what remains of the Brazilian economy, he will have to take actions in a diametrically opposite direction. Brazil's economic and financial problems did not stem from an excess of state intervention into the economy, but rather from precisely the reverse. No solution to the exchange crisis can escape the necessity for strict exchange controls to to protect the national economy from foreign speculative capital.



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