Cardoso leads Brazil into hell

by Lorenzo Carrasco Bazúa

The dramatic collapse of Brazil's stock markets at the end of October and early November, matching the panic in stock markets worldwide, showed just how much of a fraud the Fernando Henrique Cardoso government's much-touted "monetary stability" really is. Brazil is now on the chopping block of the international speculators, slated for final slaughter unless it complies, and fast, with every last demand of the financial vultures.

Over the course of the immediate crisis, the São Paulo stock market dropped by 30%. On Oct. 27, following three days of continuous decline in the markets, foreign speculators decided to pull *part* of their money out of Brazil, provoking the collapse of the São Paulo market. Speculation and capital flight were so enormous, that on Oct. 28, the Central Bank was forced to sell about $10 billion in dollars, of which about $5-6 billion left the country the same day. Capital flight throughout the week is estimated to have been close to $9-10 billion, leaving foreign reserves at $50 billion, down from $60 billion.

Panic first took hold of the government, starting with the President himself, followed by Finance Minister Pedro Malan, and then Central Bank President Gustavo Franco. At the beginning of the week, the petulant Franco dismissed the gravity of the crisis, actually claiming that Asian volatility would benefit Brazil, because capital fleeing that part of the world would come to Brazil. But by Oct. 31, he had come down from the clouds, and admitted that "we're in the middle of a storm, and it's harder to fly the plane under these conditions. I don't understand this crisis, because there's no logic to it. We don't know what's going to happen tomorrow."

Also fueling the panic is the fragility of Brazil's foreign reserves, because two-thirds (about $40 billion) consists of short-term, volatile capital, which can disappear overnight. Strictly speaking, they are hardly reserves at all; in fact, they are just accounting entries, for which Brazil pays dearly, as if they were renting their services on a monthly basis, while guaranteeing their right to withdraw on a moment's notice.

The truth is that the Brazilian crisis has only just begun, and even if international markets are able to reduce volatility, at least in the short term, Brazil is headed toward huge domestic financial turbulence. This, in turn, can feed the world financial crisis, both because Brazil is the Third World's largest debtor, with over $200 billion in official foreign debt, and because Brazil's collapse would pull all the rest of the Ibero-American markets down with it. Despite assurances that they are okay, Mexico and Argentina are panicked that they are next in line, and that a Brazilian firestorm would instantly engulf their equally exposed economies.

A repeat of Mexico . . . but bigger

The bitter irony in all of this, is that Brazil's crisis today is a virtual repeat of Mexico's crisis of 1994-95, although in a much more volatile international environment: Brazil has a vast trade deficit as a result of trade policies, which it has papered over with derivatives and speculative capital flows that built up a huge, cancerous financial bubble. Even worse, so far, Brazil is imitating, measure for measure, the disastrous policy responses taken by Mexican President Carlos Salinas de Gortari and his successor, Ernesto Zedillo.

In the face of this crisis, and trapped by his own monetarist schemes, President Cardoso had two principal options to try to halt the capital flight. The first would have been to accept a 10 to 30% devaluation of Brazil's currency, the real, which would have had an immediate, devastating effect. It would have provoked monetary chaos, putting an end to Cardoso's reelection aspirations, and instantly engulfing neighboring Argentina, whose economy depends totally on Brazil as its major export market, in an unsustainable situation.

In the middle of this crisis, Argentine President Carlos Menem phoned his Brazilian counterpart several times, begging for guarantees that the real would not be devalued. According to Menem's own report, Cardoso replied, "If we devalue, who knows where we'll end up." The Argentine President told local media, "I spoke with the Brazilian President, who, in these very words, said, 'Carlos, there is no doubt of this: If we devalue, then you'll have to devalue, and who knows where we'll end up.' "

Rejecting that option, Cardoso opted for the only other course acceptable to the speculator vultures: a brutal increase in primary interest rates, doubling them from a monthly level of 1.58%, to 3.05%. For basic bank interest rates, this means an increase from 1.76%, to 3.23%, or an annual rate of 43.4%, by which the government hopes to keep speculative capital inside the country.

To stop the flight of "motel capital"—that which comes in at night and leaves in the morning, without producing anything—the government's economics team, with the President at its head, is acting like the manager of a brothel. When his clientele declines, he lowers the price of his services, offering, as São Paulo Mayor Paulo Maluf put it, pornographic interest rates. Maluf is a potential rival of Cardoso's in the next Presidential elections.

This is pretty much what Mexico did at the end of 1994. In a matter of weeks, the country spent $11 billion of its $17 billion in reserves, and tripled its interest rates from 13% to 40% annually. Despite these measures, the peso was devalued by more than 40% (see **Figure 1**).

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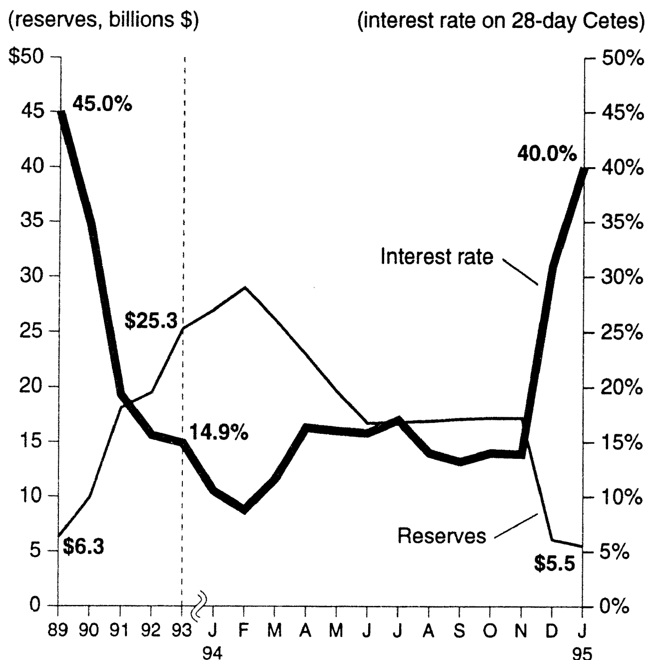
FIGURE 1
Reserves and interest rates in Mexico



Sources: Banco de México, IMF.

The President's bets

Before this crisis exploded, and with the aid of $500 million annually in official propaganda, President Cardoso had cultivated the image that the only alternative to his program of "monetary stability" was chaos; and that the capital flows which fed the growing balance-of-payments deficit, would last long enough for him to be reelected at the end of next year. In statements published in *Jornal do Brasil* on Oct. 20, the Central Bank's director of foreign affairs, Demostenes Madureira de Pinho, predicted that foreign capital flows would last more than 10 years. But, they didn't even last a week.

The President explained his gambling operation in statements to the editor-in-chief of the daily *Gazeta Mercantil,* published on June 19 of this year. Here, he confessed that he was pushing the country into the casino of the international financial system, betting that the system would collapse over the next three to four years. He admitted, "We're making a bet that this risk [of a world financial crisis] is temporary. You know that in politics, as in economics, you always have to take some chances, because politics is the domain of the unforeseeable. . . . What do we bet? That we are in a phase of changing the structural pattern of our productive system. . . . So this is our bet, and we hope that this will go on for three or four years. And, in this period, although there will be deficits . . . the conditions exist for a climate of development and political stability, as well as the ability to attract capital to finance the deficits."

Even as he placed his bets, the President was fully aware of the risk of a systemic crisis in international finances, as he himself revealed in his answer to the first question of that interview: "What is the thing you most fear at this moment . . . from every point of view?" Cardoso responded: "What could have negative consequences here, would be a breakdown of the world financial system. I do not foresee this occurring, but it is something that would affect us, because we do not have the means to control the situation." His second fear, he explained, is the possibility of a generalized social convulsion.

It is clear that President Fernando Henrique Cardoso lost both his bets, because a deep institutional crisis now looms as the result of the imminent bankruptcy of the Brazilian economy. The same thing happened to the bets placed by Mexican President Carlos Salinas de Gortari, whose loss meant Mexico's bankruptcy in 1994.

The outline of the crisis

The outlook would be simple, if the situation were limited to a mere stock market or institutional crisis, no matter how grave they might be. But the reality is, that the fall in the Brazilian markets reveals multiple, interwoven crises.

First, the leveraging of the financial system which led to the excessive over-valuation of assets, especially in the São Paulo stock market, on the assumption that the massive privatizations of the state companies would attract a continuous flow of foreign capital, has entered a phase of reverse leverage which threatens to provoke a chain-reaction bankruptcy of the national financial system as a whole.

This means that the massive outflow of foreign capital cannot be viewed linearly as similar to past crises, since, because of the leverage, the financial system carries a retarded potential of much greater destructive capacity than the simple loss of foreign reserves. That is why the Central Bank, from the onset of the crisis, made large amounts of liquidity available to the banks, to head off a crisis of generalized insolvency, at the same time that it brutally raised the prime interest rate.

This measure to brake the outflow of foreign capital, will have disastrous consequences for the real economy of Brazil. Initially, it delivers a blow to the financial system itself, which already faced such high rates of arrears on its loans, that various banks closed in the last year. Second, the rise in interest rates, which translates into annual interest rates of up to 50% for many clients, will violently affect agricultural and industrial economic activities, provoking a drastic collapse of employment and industrial activity. And this will obviously worsen the broad social unrest in the country. As the vice president of the São Paulo Industrial Federation (Ciespo), Mario Bernadini, remarked, the government is prepared to defend the value of the currency "down to the last industrial job and the last industry." Already, in September, before this phase of the crisis hit, unemployment had reached record levels of 16.3% in Greater São Paulo, with an accumulated

FIGURE 2
Brazil: balance of trade versus debt service
(billions $)

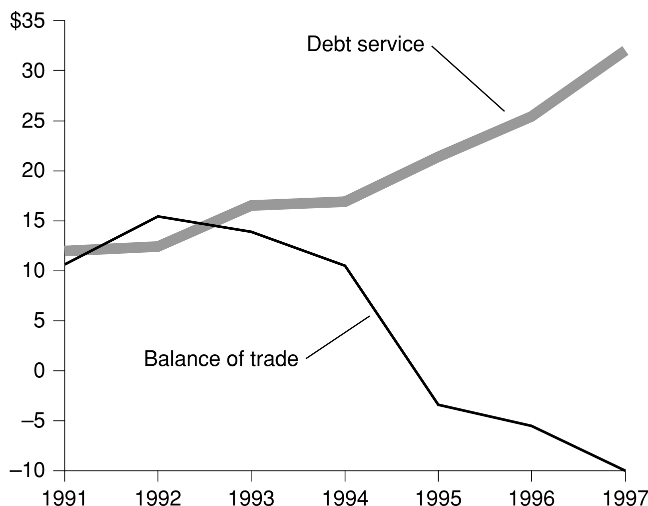
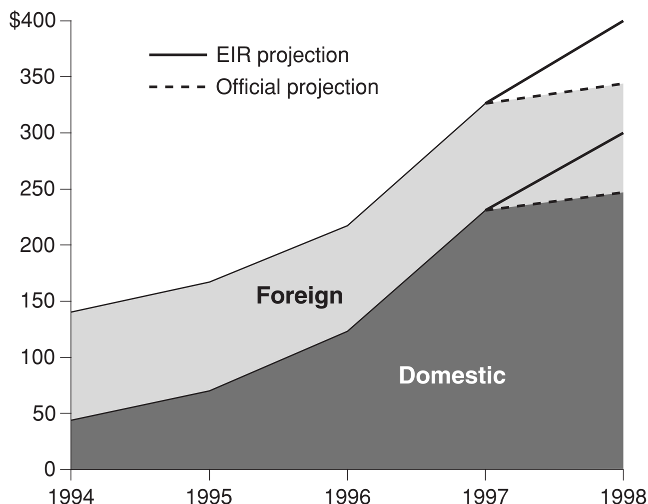


FIGURE 3
Brazil: total government debt
(billions $)



Source: National Treasury Secretariat. Brazil.

250,000 layoffs from the industrial sector since the inauguration of the Cardoso government.

Domestic debt

Another time-bomb is the effect of the interest rate hike on the federal public debt: The government will have to pay an additional $2 billion in interest payments *per month*. To get a clear idea of just how insane this is, consider how the rate of expenditures on debt service (interest and amortizations)—public and private—had already been accelerating. Last year, debt service payments totalled a bit less than $25 billion. Before the latest hike in interest rates, the Central Bank itself projected that debt service would jump to $32 billion in 1997, a figure which now looks to rise to over $35 billion. If these interest rates are maintained, payments on debt service in 1998, initially calculated at $34.4 billion, could jump to nearly $50 billion!

Under the perverse algebraic logic of the Brazilian government, this means that it will have to make it even easier for hot international capital flows to enter Brazil, because it will need some $60-70 billion to balance its books in 1998. As the government has decided to maintain the value of the real no matter what, over the coming year, this means that it will continue incurring growing trade and balance of payments deficits. This year, the trade deficit will be more than $10 billion, and the balance of payments deficit, close to $34 billion. For next year, an even greater balance of payments deficit is projected, possibly on the order of $40 billion (see **Figure 2**).

This devastating reality is seen also in the growth of the federal government debt (domestic and foreign), especially after 1995, when Cardoso came to power (see **Figure 3**). According to the figures of the secretary of the national treasury itself, published in *Gazeta Mercantil* on Oct. 14, the government calculated that from December 1996 to December 1997, total public debt grew by 54%, from 231 billion reals ($210 billion) to 356 billion reals ($320 billion), basically as a result of the increase in the government's domestic debt, since the government's foreign debt component remained more or less constant in this period.

The government had intended to stabilize its debt at around $378 billion, for the end of 1998. But that was before the current crisis. *EIR* estimates that in reality, the public debt will probably be greater than $400 billion by the end of 1998. Along with this picture of public indebtedness, one has to also consider the private foreign debt, which in 1996 (the latest figures available) was around $100 billion; by the end of 1997, it will probably be closer to $150 billion.

The picture is no less dramatic for states and municipalities, whose public debts are around $50 billion.

Camdessus's kiss of death

The rapidity with which International Monetary Fund (IMF) Managing Director Michel Camdessus moved to support the increase in interest rates adopted by President Cardoso, and demand the new level of economic looting required by the international financial oligarchy, was revealing. Camdessus called the decision of the Central Bank, "the first strong indication, in the monetary field, of the effort which the government intends to display in other fields." Those "other fields" are economic and fiscal reforms which the government has sent to Congress, to impose a greater level of austerity.

This also means a greater opening of the national banking system to foreign groups, especially the British, which, as in the case of Mexico, will end up owning virtually the entirety of the country's banking system.

The government also intends to immediately proceed with its program of privatizations, especially in the areas of electricity and telecommunications, despite the fact that the fall in the stock markets depreciated the value of the companies being offered for sale, which means that the government will receive less money for them. The government had expected to raise $80-100 billion from the privatization of these two sectors (in addition to the $32 billion which it has received from privatizations so far); but now, it will receive much less.

The process of denationalization and deindustrialization will also accelerate, as part of a deliberate policy of what Central Bank President Franco called "creative destruction," citing Austrian economist Joseph Schumpeter, last year.

As we see, everything is a house of cards collapsing before our eyes. We conclude by quoting what we wrote in these pages in August 1995: "Like trained dogs, the economic collaborators of President Cardoso are dancing to the tune of international financial capital flows. . . . The bubble will burst, and the circus put on by the pet dogs will end in the generalized bankruptcy of the country."

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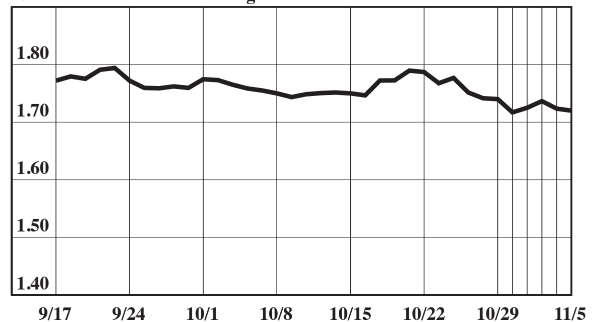
Currency Rates

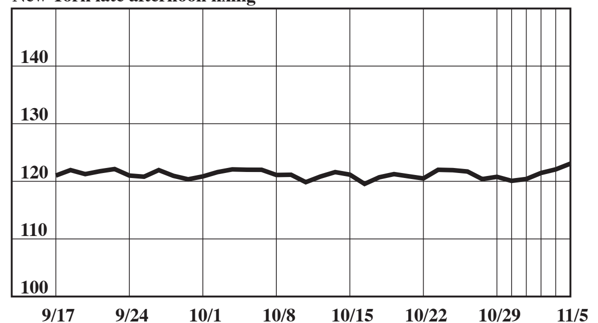
The dollar in deutschemarks

New York late afternoon fixing



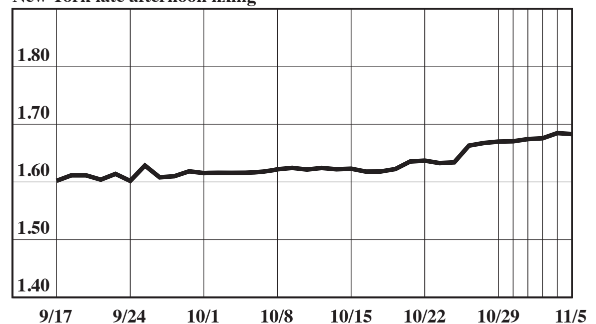
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing