The hour of truth: shock treatment for Brazil's foreign debt?

by Lorenzo Carrasco Bazúa

The international creditor banks so notorious for proposing "shock" as the miracle prescription for all the economic problems of the debtor nations, without regard to the social damage incurred, could end up "damaged" themselves, if Brazil's Collor de Mello government decides to implement what certain officials are ironically calling "shock treatment for the foreign debt."

Thus far, President Fernando Collor de Mello has been explicit that service payments on the foreign debt will be subordinated to guaranteed economic growth rates above an annual 5% of the GNP. Economics Minister Zelia Cardoso de Mello (no relation) has simultaneously set a maximum limit on annual interest payments of $5 billion. By establishing a ceiling on interest payments, the Brazilian government presumably hopes to reduce the principal amount of the debt to a level compatible with pre-determined payment limits, that is, to one-third of its current nominal value.

The Collor government has also refused to make a "symbolic payment" on the debt; the amount of $5 billion, equivalent to accumulated interest arrears, has been suggested. That refusal will enable it to renegotiate with the banks from a position of strength and with foreign exchange reserves in excess of $10 billion. This year alone, $60 billion of the Brazilian debt comes due.

Apparently, the design of Cardoso's economic team is to re-launch the renegotiation process interrupted by former Finance Minister Dilson Funaro's departure from government. Cardoso, along with many of her team, was among the now-deceased minister's collaborators. In a December 1987 article Funaro wrote for *EIR*, he explained his original intentions in declaring the February 1987 moratorium, which we cite in part:

"The telex suspending interest payments owed by Brazil to the banks clearly states that the moratorium would be suspended when—and only when—the two parties find a definitive solution to the crisis basically created by the creditor countries.

"The only approach which would guarantee the growth of our economy, opening prospects for all economic actors, is a definitive solution to the crisis such that Brazil could plan at least five years ahead, instead of remaining at the mercy of rules which only benefit one of the parties.

"To abandon the moratorium at this moment is to abandon discussion of non-conventional paths to overcome the foreign debt problem. We will surrender our country's strongest bargaining card, but even more important, we will be withdrawing from the key discussion of the crisis which the international financial system has been in since 1980-81. Blunders in the economies of the rich countries are paid for by developing countries like Brazil, always leaving the bitter taste of recession, economic stagnation, and resulting political instability."

The hyperinflationary threat

Funaro's words remain true today. The decision to suspend the moratorium in August 1987 only produced the political decline and discrediting of the Sarney regime, giving rise to the mis-government which culminated in the threat of hyperinflation, since inherited by successor Collor de Mello. Despite its commitment to punctually meet interest payments, Brazil was again forced—this time silently and without the political backlash—into a debt moratorium as of September 1989.

With its monetary and fiscal reform, the new government has—until now—successfully controlled the hyperinflationary process. It will not defeat it, however, until the original cause of the hyperinflationary threat is uprooted: the immense transfer of resources abroad as foreign debt service. As long as the monetary reform, known as the *Plan Brasil Novo,* keeps two-thirds of domestic bank holdings frozen, the Collor government will be unable, morally and politically, to offer foreign creditor banks a solution other than that applied to its own banks—namely, the depreciation of its debt to, minimally, one-third of its nominal value.

The 'Vital Decade'

Although the details of the Collor government's debt renegotiation strategy have not yet been revealed, it is universally understood that Brazil can no longer exist as a sovereign and independent nation if it continues to be subjected to the looting conditions imposed during the past decade. The next ten-year period must be one of accelerated growth, if the country is to achieve its dream of becoming a great nation.

That dream is clearly represented in a document produced by the Superior War College under the title "Vital Decade," and presented on April 5 by retiring General Oswaldo Muniz Oliva. The general declared, "This work—courageous, serious, objective, and realistic—takes a Brazil without clear standing in the world, and projects forward to the year 2000. A copy of this work was offered as a gift to the excellent President of the Republic Fernando Collor de Mello, in hope that he may find it of use to our people."

"Vital Decade"—which will be the subject of future commentary in *EIR*—addresses the solution to both the foreign and internal debt problem as a pre-condition for the return, as of 1992, to accelerated growth rates of 7% of the GNP, following an initial two-year period of stabilization at 5% growth rates. The goal is to generate 1 million jobs per year throughout the decade, with emphasis on the rapid development of the physical infrastructure of the economy, such as transport, energy, and communications, and the advance of capital goods and high technology industries.

"The basic points of the renegotiation," says the Superior War College paper, "can be listed as follows:

"1) Reducing the principal of the debt in accordance with the effective value of the respective bonds on the U.S. financial market, and with the amount of interest already paid by the country;

"2) replacing fluctuating interest rates by fixed ones;

"3) 'securing' the readjusted debt at long-term, low interest terms and with options regarding these two elements;

"4) suspending 'relending' for an extended period;

"5) establishment of clear rules for formal debt conversion, which may only take place in quantities established yearly by the government, discounts in agreement with public auctions, and allocation of the product of formal conversion into investments in the North and Northeast, and into structural development projects in the other regions—excluding under any circumstances the purchase of existing assets;

"6) transformation of interest owed for the first three years into bonds whose characteristics will depend on arrangements reached on points 1-5 above" (see *Documentation* below for further details).

This proposal of the Superior War College reflects the interests of the Brazilian state and a national consensus to resolve the suffocating foreign debt problem. Upon the solution to this problem depends the future of the new government, which is well aware that a retreat in the debt negotiations will mean total loss of domestic credibility, which in turn could lead to the violent return of hyperinflation and institutional instability. The hour of truth has arrived in Brazil, and the consensus appears to be growing that it is time for the bankers to get a taste of their own shock therapy.

Documentation

Excerpts from '1990-2000: The Vital Decade'

The following are excerpts translated from Chapter III of a document recently issued by Brazil's Superior War College, entitled "1990-2000: The Vital Decade." The chapter we cite is called: "National policy: Brazil on the threshold of the Twenty-first Century."

During the next decade, Brazil should orient its development so as to situate itself, on the threshold of the 21st century, among the great democratic and developed nations. . . .

It is a matter of definitely opting for wealth: wealth to be generated by Brazilians through work, dedication, intelligence. But wealth to be distributed to all who contribute, by their effort, to producing it. Work is everyone's province, both as a duty and a right; the just distribution of its benefits is also the duty of those who lead, and the right of those who participate.

At the same time, in rubbing shoulders with the great countries on the international scene, Brazil's voice must make itself heard against the clamor of inequalities that prevail in this world, and in favor of the helpless.

This national design is not merely possible and desirable; it derives both from the very dimension of national power, relative to that of other countries, and also to its capacity—by necessity, duty, and right—to mobilize.

We are the fifth-largest country in territory in the world, with vast known natural resources . . . still unexplored to a large degree. We are today the sixth-largest in population, although the need for a great national effort to train our human resources must be recognized. We are the tenth economy in the world in terms of the gross national product, on the order of $385 billion (1988). Industrial manufactures, estimated at nearly $104 billion (1988) is ninth in the world—and these have already reached a high degree of diversification, cross-sector integration, and reasonable international competitiveness. What is cause for serious concern is the fact that the *per capita* GNP of Brazilians, on the order of $2,700 (1988), is below the world average, estimated at $3,000 in 1988; to this can be added the fact that the inequities of internal distribution are only superseded by the inequalities that divide the nations of the world between rich and poor. In terms of per capita GNP, Brazil is in 40th place among nations with more than 1 million inhabitants (1988), and worse still, its growth has come to a virtual standstill in this decade, in comparison to growth rates of nearly 5% between 1960 and

1980. . . .

Therefore, the need is clearly to rekindle economic growth in the course of this new decade, to levels equivalent to those of the 1970s, as the necessary if insufficient condition for development in the economic, social, and political spheres.

3.1. The economic dimension

There is no solution to short-, medium-, and long-term national economic problems that does not imply reviving economic growth.

In the short term, *a policy of adjusting the economy by means of growth,* and not recession, is necessary to overcome obstacles posed by inflation, by inadequate savings and their orientation to non-productive applications, by low levels of investment, and by the financial gambling that immobilizes the state indebted internally and externally. . . .

In the medium term (through 1994), Brazil must return to its *historic trajectory of growth,* on the order of 7% of GNP per year (nearly 5% per capita), in view of the need to generate new jobs and to achieve a dynamic redistribution of wealth, keeping pace with growth.

In the long term (through the year 2000), Brazil needs to achieve a new economic level, with a doubling of its GNP (which should surpass $800 billion, in 1988 prices, by the beginning of the 21st century), and with per capita income on the order of $4,500. Per sector, a new, more advanced phase of industrialization must be reached, while consolidating Brazil's vocation as a major producer and exporter of food and agricultural raw materials . . . and the recovery, expansion, and modernization of energy, transport, and communications infrastructure. In sum, *to consolidate through the year 2000 a different productive sector, modern, more efficient and competitive.* Such a sector would be grounded in the internal market, but capable of dynamic and multiple involvement in the world arena, both on the level of trade relations (with a yearly volume of imports and exports on the order of $150 billion), and in financial relations (with a more respected, relatively stable currency, increasingly accepted internationally).

3.2. The social dimension

The revival of growth will restore conditions of viability for carrying out a *policy of social transformation,* oriented synergistically toward the creation of new jobs (in numbers adequate to absorb growth in the economically active population and to reduce underemployment), to improve income distribution, to fight critical poverty, and to increase the value of national human resources.

Globally, the objective of such a policy of social transformation can be expressed in the *incorporation, during the next decade, of an average 5 million Brazilians per year into the consumer market,* through absorption of nearly 1 million new jobs a year into the organized economy, which would at the same time affect the expansion of the internal market and income distribution.

The touchstone of this policy of social transformation should be *the complete guarantee of equality of opportunity,* providing for the fulfillment of the individual, enabling one to freely attain one's life goals and to see one's effort rewarded in an open, pluralist, and united society. . . .

V. The foreign debt

In the case of the foreign debt, renegotiation with private creditors is an imperious necessity, obviously justified in view of the debt's many internal ramifications. . . . The opening of renegotiations should follow a clear presentation to both the official and business world of the United States and to other great creditors, on the constitution of the debt through time, on the effective use of the respective credits, and on the effects those colossal payments have had on the internal economy. Such an eminently technical presentation should be released to the public of the creditor nations, which is otherwise fed two stereotypical views: that the loans which made up the initial debt were made with the savings of the lender countries—when in truth they were largely made through the recirculation of petrodollars—and that the debtor countries persist in their attitudes on being either bad or nonpayers on the debt.