

Brazil's President uses economic 'shock' program against speculators

by Peter Rush

Incoming Brazilian President Fernando Collor de Mello decreed, one day after taking office on March 15, one of the most sweeping monetary and financial reforms of any nation in the 20th century, shocking the financial markets, but winning instant support from most Brazilians and many abroad. His measures in one stroke froze nearly \$100 billion in internal government short-term debt and \$20 billion in bank savings accounts, liberalized foreign trade and currency exchange, and imposed taxes for the first time on the nation's wealthy. One week after their imposition, prices had fallen sharply, the national currency had appreciated 50-75% against the dollar, and retail sales plummeted.

The measures confounded virtually all critics. Nobody had anticipated such a dramatic freezing of accounts and reduction of liquidity in the economy. After one week, it is clear that Collor means business. What is not clear, is whether the measures taken so far may be the opening salvos of a monetarist "shock" program. If so, the hopes of the mass of Brazilians who so far are supporting the new President's bold approach, will soon be dashed, as layoffs and other austerity measures take their toll.

However, the measures taken so far may just as possibly be the prelude to an entirely different type of "shock" program, one that genuinely roots out the speculation and manipulation of financial markets by the elite of Brazil's upper class, establishes sound government finances, does not visit austerity on the vast majority of Brazil's working class and poor population, and recommences the ambitious national development projects that have been on hold since the debt crisis first hit in 1982.

So far, Collor has acted consistently with either scenario, decreeing the liberalization of the economy, but also showing concern that the mass of Brazilians not be negatively affected.

The measures

Zelia Cardoso, Collor's 37-year-old finance minister, released an outline of the new measures on March 16. They include:

Monetary and financial measures:

- Creation of a new currency, the cruzeiro, to be ex-

changed one-for-one for the previous New Cruzado (NC);

- Freezing for 18 months of all funds above NC 25,000 in the so-called "Overnight," the one-day government bond indexed daily to inflation, in which nearly half of all the nation's currency used to be invested daily;

- Freezing for 18 months of all funds above NC 50,000 in bank savings accounts;

- A 30-day price and wage freeze, retroactive to March 15, the day that retailers started jacking up their prices in anticipation of Collor's package; a 5% increase in the minimum wage;

- Five-year prison terms for economic abuses such as unauthorized price increases and hoarding, and use of the police to enforce the measure;

- Abolition of anonymous, numbered money market accounts, used to evade taxes and launder drug money.

Government budget and tax measures:

- Taxation of large fortunes for the first time;

- Imposition of income taxes on farmers; a capital gains tax of 35% on gold trades, 25% on stock transfers;

- Increases in telephone rates, gasoline prices, air fares, and postal rates, respectively, of 32%, 58%, 50%, and 80%; electricity and water rates will also go up sharply;

- Setting of annual interest rates on frozen "Overnight" accounts of 6% above the inflation rate, replacing the present rate of more than 50% above the inflation rate; this measure alone is expected to drop the government deficit nearly to zero;

- Dismissing 30-40,000 government workers who hold two government jobs;

- Eliminating many government ministries and agencies, and dismissing many of their employees; ending \$2.2 billion in subsidies to exporters and manufacturers;

- Tight control of printing of cruzeiros; none to be printed to finance government deficits;

- Privatization of most government-owned companies, especially manufacturing firms;

Foreign trade and exchange measures:

- Floating exchange rate set by free market through supply and demand of importers and exporters;

- Gradual phase-out of import barriers and licenses;

- Strong encouragement for foreign investment.

Collor vows: no recession

Speaking before a joint session of Congress March 15, Collor reiterated his campaign promise that fighting inflation would be his top priority. "The struggle against inflation will be an unconditional struggle," he said. "I will never relent in the pursuit of this objective. I will either win or lose to the extent that this challenge will be met without delay and without pause." He identified inflation as "permanent aggression against wage earners, against the vast majority of our people. The poorest classes are precisely the ones that are unable to defend themselves from inflation and resort to other means."

In its first week, the package of measures did succeed in fulfilling this objective, not only rolling back inflation rates, but prices themselves. By March 23, many stores were quoting prices well below even the March 15 level. However, there was also a sharp fall-off in retail sales. Analysts attributed this to the fact that an estimated \$100-120 billion, out of \$150 billion in liquidity, was suddenly frozen.

However, the real explanation is initial panic or uncertainty, compounded by sabotage by some banks that at first refused to permit even the legally allowed withdrawals by consumers. Relatively little of the frozen money would normally have been spent on retail items. Most people, whose funds are not frozen, have just seen the purchasing power of their wages and money go up, as prices have fallen.

Nonetheless, some critics immediately attacked the program for being recessionary, and predicted a mass of layoffs and a collapse of production, while the newspaper *O Estado de São Paulo* raved that Collor's program was "interventionist," a return to dictatorship, and a throwback to the regime of Getulio Vargas, a nationalist who was President in the 1930s and 1940s.

Anticipating this criticism, Collor in a televised interview March 18, answered flatly, "There is not going to be a recession." He said that his plan only affects the wealthiest 10% of the population that had more than the specified minimums in the "Overnight" and in savings accounts. He also said that the central bank would hold auctions soon, where those whose funds are blocked could buy some of them back, albeit at some discount from full value, to "irrigate" the economy. Five days later, making good on his promise to be flexible, Collor announced the first change in the original plan, which will benefit retirees and the unemployed, and farmers will be allowed access to frozen funds to pay wages. Collor also announced that if inflation is licked quickly, the blocked accounts can be released early.

In his speech to Congress, Collor also claimed to have a great concern for the well-being of the average Brazilian, and awareness of the inequity of Brazil's distribution of wealth. "My generation" he said (he is 40), "no longer accepts coexisting with a Brazil that is an economic giant, but

a social pygmy; living in the world's 10th largest economy, with social indicators that reveal so much misery, disease, and inequality." He added, "We do not conceive of modernization without its component of social justice; of progress that is not shared by everyone."

But he also stressed that "it is up to free enterprise, not the state, to create riches," and that the proper role of the state does not extend to producing goods. He said an important part of his program was to attract foreign capital to "diversify our industry, create more jobs, and obtain technology for the benefit of Brazil and the countries of the Third World." He also committed his government to improving education and literacy levels as one of his top priorities.

However, conspicuously absent from Collor's public statements has been any mention of the role of the state in developing infrastructure and great projects, such as the Gran Carajás iron and metallurgical project, which has been turned into nothing but a looting operation to pay debt service to the international banks. Without such a perspective, no short-term monetary success in the fight against inflation can become the basis for permanent growth. However, an indication that some people are looking at this area as well, is the creation of a new Ministry of Infrastructure.

Debt moratorium: the Funaro legacy

In his speech announcing his new economic program, Collor said, concerning the foreign debt, "It is not a matter of seeing how much we can grow after servicing the debt, but rather how much we can pay after guaranteeing our economic growth. . . . We must struggle so that the '90s restore and accentuate the trajectory of growth. One of the main obstacles to that, without doubt, is servicing the debt at current levels." Giving substance to this statement, Finance Minister Cardoso announced a de facto partial debt moratorium, without using the term, saying that Brazil would pay no more than \$4-5 billion a year in interest charges, less than half of its annual interest owed.

Not only the debt decision, but the entire package has been likened to the measures favored by the late former Finance Minister Dilson Funaro, the architect of the 1987 debt moratorium. Maria da Conceição Tavares, an economist and strong partisan of Funaro's program, said in a television interview March 20 that "Funaro must be very happy, up there in heaven, because this is just what he tried to do." The plan was "technically perfect" and "the best that has ever been done in this country," she said.

It may thus be no accident that Zelia Cardoso served under Funaro during his tenure as finance minister, and made a special point of visiting his grave after Collor's inauguration, where she spoke of "the guidance of the memorable minister Dilson Funaro, to whom I once again render homage for the dignity and public spirit which characterized his life. It seems significant to recall that moment, for the image he left of mobilization of the citizenry."