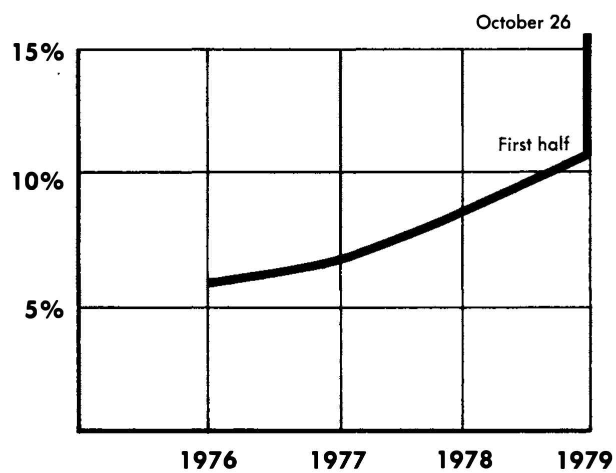
Decoupling the developing sector

U.S. Federal Reserve credit policy means catastrophe for Brazil

Eurodollar interest rates



Almost all of the money borrowed from private banks by developing countries and other borrowers for terms of over one year is indexed to LIBOR (London Inter-Bank Offering Rate). The interest payable for each semester on the loan is figured at some percentage (or spread) above the interest rate on loans between banks made in London at the beginning of the semester.

While only about half of the developing country debt is specifically tied to the LIBOR rate, the interest rates on new fixed-rate, short- and long-term loans tend to rise in tandem with the LIBOR rates.

As the graph shows, LIBOR borrowers are now paying more than double the interest on their debt than expected when they contracted it.

Source: the IMF and the **Financial Times**, Oct. 27.

Brazilian Finance Minister Karlos Rischbeiter has warned that the Volcker-Fed policy of forcing up interest rates will have "catastrophic" effects on Brazil and other developing countries. Speaking in Paris on Oct. 8, Rischbeiter observed that each 1 percent increase in average Eurodollar loan rates in London costs Brazil almost $500 million a year in additional interest on its $50 billion in debt. Those rates have risen by 7 percent over last year's average. (See graph)

During the period immediately following the manipulated 1973-74 oil price increases, major oil-importing Less Developed Countries were encouraged to run up large debts to cover their oil import bills and other necessities. Now, with oil prices again going through the roof, the Council on Foreign Relations has decided that developing countries ought to be "de-coupled" from international credit and squeezed dry to pay their existing debts. Such genocidal policies have been effected for some years on the poorer countries, including most of Africa and Southern Asia. Now, even Brazil—where Citibank earns more profits than it does in the U.S.—is being cut loose from the credit flow it needs.

Bankers will shuffle debt paper in order to mask the actual bankruptcy of Brazil. Its debt is so large that default would shake the whole Eurodollar system. But, in return for preserving the fiction of solvency, Brazil will be forced to put itself through the ringer. Its decimation will be reflected even more rapidly and hideously in the less well endowed nations of the Third World.

During the first half of this year, debt service alone consumed 83.9 percent of the money Brazil earned through its exports, according to figures released by the country's central bank. Repayments of loan principle were up 24.7 percent from last year, while interest—even before the recent rapid rise in rates—was 65.9 percent more than last year. Brazil's debt profile is such that there is no end in sight to the spiraling of debt costs.

As things stand now, Brazil will spend over $11 billion of its $15 billion export revenues on debt service, and will have to shell out about $7 billion more just for oil this year. To cover its accounts deficits it will have to borrow about $11 billion and run down its foreign reserves by $3 billion.

'Brazil has no choice'

The need to borrow ever-increasing sums to repay past debts and cover current trade deficits (well over $2 billion for Brazil this year) is the point of greatest vulnerability for developing countries.

The Anglo-American banking centers are therefore ordering Brazil to embark immediately on another round of accumulation against its own population and productive capital base in order to stop increasing indebtedness.

"Foreign Debt and Economic Growth in Brazil," a recent study by Chase Manhattan Bank's Brazilian affiliate Banco Lar, concludes: "Over the next several years, Brazil has no choice but to avoid dependence in large degree on foreign savings to finance capital formation. ... Substantial additional inflows would excessively tax Brazil's debt service capacity. ... Brazil will have to increase its domestic savings level" by reducing consumption, governmemt services and productive investment. Therefore, Chase insists, Brazil will have to follow a low-growth path with radical austerity, a credit crunch against industry, and further cuts in wages. If Brazil devolves into a labor-intensive hell-hole devoted to exporting everything it can, and cutting fuel and food imports, Chase thinks that by 1985 it will be able to start reducing its total indebtedness.

No more 'miracles'

On the surface, Brazilian Planning Minister Delfim Netto abhors the monetarist demands of Chase, and of his predecessor, Mario Simonsen, that Brazil be put into a domestic recession in order to "fight inflation." No, says the economics 'czar', "the word 'recession' is not in the Brazilian dictionary. We must provide jobs for the 1.6 million youth who enter the labor force each year." Yet, Delfim's own "growth" strategy is a disguised way of meeting Chase's imperatives.

Delfim plans to prevent default on the $50 billion in debt by raising exports from $12.6 billion last year to $20 billion next year, and $40 billion in 1984. The trick is to get that kind of export boom without either borrowing heavily for the export industries and related energy sources, railroads, ports, and so on or allowing production costs (wages, fuel, raw materials) to cause comparable increases in imports. Delfim's solution is to focus "growth" on resettling populations onto the deficient soils of Brazil's vast interior, to pump out quantities of soybeans and petroleum-substitute (gasohol) crops. Industrial growth will be limited to recycling Brazil's ample industrial base from domestic to export-oriented production and adding shifts where necessary to existing facilities. In order to contain the growth of indebtedness, Delfim plans to triage state sector investments and eliminate the subsidized credit which has facilitated industrial expansion.

Brazilians are starting to wake up to the fact that Delfim's clever schemes create a series of unsolvable contradictions. For example, metalworking magnate Paulo Mangels observed at an October roundtable on the export push that the low level of industrial investment in recent years will result in a lack of exportable merchandise to increase exports. Even the much-vaunted agricultural sector is loudly complaining about insufficient credit to finance any significant expansion. At the export roundtable, Brazilian Exporter's Association President Laerte Setubal pledged his support to Delfim's export crusade, but commented that triple the current volume of exports couldn't even be put on ships without quadrupling present investment levels in export infrastructure—something clearly impossible under budgetary constraints.

Maoist autarchy

The Economist of London has a number of suggestions for how employment and production can be increased while reducing Brazil's already low wage bill (now only 5 percent of manufacturing costs). Says *The Economist*: "One possible model for fuller employment is the pre-1960 Japanese free-market one; tiny village sweatshops or cottage workrooms where all members of the family make component parts for big urban capitalist factories, necessarily at well below Brazil's present legislated minimum wage of $2 a day.

"An alternative system is communist China's system of village Keynesianism, by creation of a secondary local currency called the work point, and by village infant industry protection. The commune's old women and some children sit making sandals, and are paid in work points."

A U.S. State Department official who studied *The Economist's* slave-labor recommendation commented, "There's enough truth in it to make a valid argument."

The triage policy is not as simple as it sounds. A child from the slums asked Brazilian President J. B. Figueiredo what he would do if his father had to support a family on the minimum wage. Figueiredo answered with characteristic frankness, "I'd put a bullet through my noggin." *The Economist* recognizes, "If a squeeze was imposed on Brazil at present, with the Sao Paulo trade unions thinking they are about to celebrate an opening to populism, the consequences could be

Brazil's balance of payments

In billions of dollars

	1978	1979		
	Jan.-June	Jan.-June	Jan.-Dec.*	Jan.-Dec.*
Exports	12.7	6.8	15.3	14.5
Imports	13.6	7.5	17.2	17.2
Trade deficit	− 1.0	− 0.7	− 2.0	− 2.5
Service account deficit	− 4.9	− 3.7	− 6.0	− 8.5
Interest on debt	− 2.7	− 2.5	− 3.5	− 6.0
Current account deficit	− 5.9	− 4.4	− 8.0	− 11.0
Net capital inflow	9.8	2.7	5.5	
Foreign loans	14.0	5.5	11.5	
Foreign investments	0.9		1.0	1.2
Debt amortization	− 5.2	− 3.2	− 7.0	− 7.0
Balance of payments	+ 3.9	− 1.8	− 2.4	
Total debt service	− 7.9	− 5.7	−10.4	−13.0
Debt service as a percent of exports	62.1%	83.9%	68.3%	89.7%

*projections

Sources:
1978 figures and those for the first half of 1979 are from the Central Bank; the first column of 1979 projections are from Fundaçao Getulio Vargas and were compiled in July 1979; the second column of 1979 projections are the latest official and unofficial projections.

explosive." Even Delfim worries about his ability to force down the real wage level—even by using the statistical tricks he employed during the "miracle." "Nobody's going to sacrifice the political opening for the economy. It's much more probable that the economy will be sacrificed for the political opening."

Depressed markets

What if Brazil does manage to triple its export production, triage investments without collapsing production, and achieve London's suggestion of reducing wages to concentration-camp levels, without provoking a social revolution? Even with such new "Brazilian miracles," will there be a world market to buy those products?

This is a question that really panics the Brazilian authorities and their bankers. They fully expect that American industry and labor will respond to Volcker's depression with massive protectionist pressures that could limit or even eradicate the market for their manufactures, and force them to sell far below cost. The Brazilian Exporters Association is studying sophistcated ways of getting multinational corporations operating in Brazil to lobby in the U.S. against the protectionist measures. Other tricks are being prepared for attempting to increase exports under trade-war conditions.

Delayed detonation

When confronted with the fact that the bankers are intent on cutting off further credits, Brazilian officials smile stealthily and laugh, "You know we have them over a barrel. They need us as much as we need them. If we went under, so would they." There is substantial truth to this argument, and the Brazilians may be able to blackmail those bankers to keep stringing Brazil along so as to avoid default. For example, Brazil recently had no trouble getting 10 lead banks and 25 secondary lead banks to subscribe a $1 billion debt roll-over loan, ostensibly for Brazil's "gasohol" program. But, coordinating-bank Morgan Guaranty confides that since Volcker issued his credit policy, they have had difficulty retailing loan participations to smaller regional bankers.

But prospects for avoiding a debt default even after committing national economic suicide are getting so dim that the pragmatic Brazilians could well jump ship.

Instead of just secretly threatening the bankers with blowing out the Euromarket if they don't cough up enough credit, the pragmatic Brazilians might soon realize that they could make better use of their substantial economic weight, by playing a leading role in creating a new monetary system.