Brazil's Controversial "Cruzado" Plan

As payment of Latin America's vast debt becomes increasingly difficult, all eyes turn towards the southern giant's bold experiment to check inflation

Is spontaneous public support sufficient guarantee for the success of a long-term economic plan? This is a question being asked about the Brazilian Cruzado Plan. Whereas the government is euphoric over the plan's initial results, critics are frankly skeptical.

Brazil is more than the home of the samba, carnivals and soccer; it is also the nation with the largest debt in the world. The South American giant owes $104 billion, and must pay out $12 billion a year in interest, as well as another $8 billion on account.

The effort to meet payments to the more than 600 creditor banks was dragging the economy into chaos and runaway inflation, which in 1985 reached 235%. Estimates for 1986 indicated the inflation rate could reach 400%.

Geraldo Holanda Cavalcanti, Brazilian ambassador to Mexico, granted **Voices of Mexico** an interview on the subject. He explained that the plan, put into effect last February 28, is basically a mechanism aimed at wiping out the tremendous loss in the purchasing power of wages because of inflation. He also made clear the reasons why it was necessary to put into effect such a non-orthodox economic plan.

"When José Sarney became president earlier this year, he tried to contain inflation by resorting to traditional means," said the ambassador. He admits that failure of these mechanisms led the government to adopt more radical measures.

Latin America's most populous nation was the first to sign letters of intent with the International Monetary Fund, but it has also been known for bending the letter of the institution's "recommendations." During 1981 and 1982, Brazil underwent the bitter experience of applying liberal monetary policies which led the country into its worst crisis in history, with three-digit inflation and outright insolvency by the end of 1982. The economy had a negative growth rate of 3.4% in 1983, while the debt swelled by 10%. Despite all of this, Brazil still signed another four letters of intent between December 1982 and the end of 1983, but never fulfilled the commitments.

Brazil signed its seventh letter of intent with the IMF during the last quarter of 1984 and managed to meet conditions half-way.

SOME FACTS ABOUT BRAZIL

	GNP % annual	Inflation % annual	Trade Balance USmillions	Foreign Debt Interest and Principal Payments	Foreign Exchange Reserves USmillions	Net foreign Debt Export Earnings
1958	9.2	23.8	- 1128	2 942.7	4 502.3	1.7
1978 (1)						
1979	6.4	54.0	- 2717	11 732.2	9 688.7	2.6
1980	7.2	98.0	- 2823	9 753.6	6 912.5	2.3
1981	- 1.6	110.0	1594	16 741.5	7 506.8	2.3
1982	0.9	100.0	817	19 502.1	3 994.4	3.3
1983	- 3.4	211.0	6472	19 383.0	4 562.9	3.5
1984	4.5	224.0	13068	17 917	11 995.3	4.0
1985	8.5*	235.0 *	12000 *	10 700 *	8 200 *	3.8 *

Observations: (1) Average for the period
* Estimates

Sources: FEV, Brazil
IDB

Although inflation ran out of control, the GNP grew 4.5% that year, and there was a trade surplus of $13 billion, all of which placed the Brazilian economy in eighth place world-wide. In 1985 Brazil ignored the IMF's prescriptions and negotiated its debt payments on the side. The economy showed real growth of 8.3% and the third highest trade surplus in the world, some $12 billion, surpassed only by Japan and West Germany.

These figures explain, to a certain extent, the decision made by José Sarney's government to implement a program that makes a clean break with the IMF's orthodox conceptions which include cuts in public spending, the sale of state-owned firms, elimination of exchange controls over a country's currency *vis a vis* the U.S. dollar, elimination of price controls and keeping a lid on wage increases, and above all, the imposition of advisors.

In contrast, the new plan consists of a freeze on prices, goods and services and on all factors of the economy, plus the establishment of the "Cruzado", the new currency that replaced the cruceiro. The freeze also includes wages and the cruzado to the dollar exchange rate.

The new plan also contemplates several mechanisms to benefit the population. Salaries, for example, are not totally frozen, but merely stabilized. In case of inflation, current legislation calls for automatic adjustment in wages of up to 60% of their loss in purchasing power. The remaining 40% is open to negotiation.

"On the other hand, unemployment insurance was also established, and this is something very agreeable to wage workers," adds the ambassador.

MAGIC OR REALITY?

The plan was a success from the very beginning; the objective was quickly met. Whereas in February inflation was 14.36%, it was only 2.08% for the first quarter after the plan was put into effect (March, April, May). In March the economy grew 5%, employment increased by 2.9%, sales went up 18% and exports 3.4%

Mr. Holanda Cavalcanti recalls the first few days. "There were attempts at fraud, changing price tags. But, the government was strict in bringing down the law on infractors. There were also attempts at hoarding products, and the government confiscated them. Some workers went on strike demanding higher wages, but these were resolved through negotiations."

The surprising amount of popular support for the plan showed in the attitudes of consumers, many of whom turned into volunteer "inspectors." The government empowered them to enforce compliance with the price-freeze, and this led to a radical change in attitudes. Whereas a few months ago angry crowds of hungry people pillaged supermarkets to steal food, now they keep watch so that goods don't disappear from the stores and prices are not hiked up. The CUT, the labor federation which openly opposes the Sarney government, explained this attitude in a document criticizing the Cruzado Plan:

"The price-freeze led to popular mobilization, a greater role in discussions and a broader base of support for the government. Why? In the first place, a freeze on prices is a secular demand of the working class. It means, if only for a short time, the disarticulation of a mechanism that complements the exploitation of labor and the accumulation of monopoly capital."

AGAINST THE WORKERS IN ORDER TO PAY THE DEBT?

Mr. Holanda Cavalcanti points to the success factor: "Our economic conditions allowed the government to take steps that are difficult to accept: there was a climate of growth and optimism, not one of depression or recession. There was also a climate of political renovation, and this too contributed to the support the government obtained."

But the opposition, particularly the CUT, says the plan also seeks to generate broad support for the regime as a forerunner to next November's elections for the Constituent Congress. The municipal elections held in late 1985 showed a clear trend toward political polarization in favor of opposition left parties, in detriment to the goverment's Democratic Alliance.

Photo by Rogelio Cuellar.

The other Brazil.

These would be the political reasons for concern. But as regards the labor movement, the CUT believes that "towards labor and unions, the plan seeks to stem the growing tide of labor and union struggles and to undermine the victories achieved through mobilizations and strikes." In this vein, the objective is to "create the necessary economic and political conditions to adjust the Brazilian economy to the needs of the world market," and to "accelerate the necessary mechanisms to be able to meet interest payments on the foreign debt." The ambassador disagrees, and says emphatically: "The plan is internal. It is not geared towards paying the debt."

DOES THE PLAN HAVE A FUTURE?

Thus far the results are obvious, and superior to those of other similar plans which also sought the same "zero-inflation" goal. In Peru, for example, inflation reached 43.8% in the four months after their plan was put into effect;in Argentina the rate was 14.23% and the country was forced to devaluate its currency by 30.5%.

The situation has evolved differently in Brazil, despite all the bad omens.

In a first, overall assesment of the plan delivered on April 14, Sarney recognized that in social terms, "we are in the same group with African and Asian countries, and this situation cannot continue because it is a terrible illness of our society." His diagnosis is supported by irrefutable figures that appear in a report prepared by Brazilian political science professor Helio Jaguaribe: over half of Brazil's 138 million people live in poverty; the current unemployment rate is close to 25%, even if the government only admits to 4%; illiteracy stands at 30%; half of the population receives only 14% of the national wealth, while 5% own 33% of the nation's income, and this is one of the most notorious rates of inequality in the world.

Unlike the more traditional medicine, this unorthodox shock treatment has produced results. The government is confident that the inequalities in Brazilian society will gradually be resolved thanks to this effort. The official outlook is that the economy will continue to perform strongly, that the trade surplus for 1986 will reach $14 billion and that for the first time in many years the balance of payments will be in the black. The GNP will increase 4.5%, although economic growth will be lower than in 1985.

For its part, the opposition Worker's Central is less optimistic, and believes the government will be hard pressed to control inflation for much longer. The CUT expects to see further strikes and mobilizations in favor of worker's demands, just as soon as the population realizes that the Cruzado Plan is just a mirage. Or as the Worker's Party leader Luis Ignacio da Silva, "Lula," says: "The Cruzado Plan doesn't resolve the problems, it just puts a freeze on them." Time will tell.★

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