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Vicissitudes of recent stabilization attempts in Brazil and the IMF alternative

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TEXTO PARA DISCUSSÃO

Nº 27

Vicissitudes of recent stabilization

attempts in Brazil

and the IMF alternative

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1. Introduction¹

This paper describes recent macroeconomic events and policies in Brazil, and attempts to evaluate the Brazilian government's decision to implement an IMF-type stabilization policy in 1981, after deciding not to go to the Fund in 1980.

Selected political events since 1968 are introduced, in order to provide a frame of reference for a description of the wage policy applied by the military regime through November 1979. There follows a discussion of inflation acceleration in 1979, leading to a delineation of the new wage policy implemented by the government late that year. Delfim Netto's unbalanced growth strategy through mid-80 is presented. This leads to an analysis of the foreign exchange shortage that caused a sharp reversal of government policies at the end of 1980. Consideration of the industrial slump of 1981 completes the descriptive part of the paper.

Evaluation of the government's decision not to go to the Fund starts with a statement concerning conflicting views on appropriate stabilization policies for Brazil. Two scenarios for a counterfactual IMF involvement in Brazilian policy making are developed, the first for mid-79 and the second for late-80. Estimates are presented of possible foreign exchange savings, derived from lower spreads on International loans, that the Brazilian government would have enjoyed as a consequence of an IMF stamp of approval over its economic policies. The paper concludes with considerations relating to possible economic costs for the country that would have derived from a 3-year attachment to an IMF stabilization program.

2. Political Prelude

The Institutional Act nº 5 of December 13, 1968, suspended constitutional guarantees and allowed an authoritarian State to prevail in Brazil during General Médici's administration (1969-73). General Geisel took over in 1974 determined to follow a path of "political decompression", which culminated with the abolishment of AI-5 towards the end of his term in 1978. Swearing "to bring democracy to this country" by the end of his mandate in 1984, General Figueiredo began his term in 1979 decreeing a complete political amnesty, that cleared Brazilian prisons of political prisoners and brought back to the country all who had been chased away by the 1964 military regime.

With the end of AI-5, long repressed wage demands were unleashed, and the labour union movement marked its rebirth with a series of strikes and Street demonstrations.

¹ Advice Paulo Batista Jr., Dionísio Carneiro and Pedro Malan, comments on a previous draft from other colleagues at PUC/RJ, research assistance from Demosthenes de Pinho Neto and financial support from PNPE/IPEA are gratefully acknowledged. The usual caveats apply.

Under an uncertain climate, newly formed political parties are now preparing to face in November 1982 a critical general election, that should alter in a fundamental way the power balance maintained since 1964.

3. Post-64 Wage Policy

The hallmark of post-1964 stabilization policy was the introduction of a mandatory wage policy, laying down a precise mathematical formula which had to be followed in all collective wage readjustments in the country. These overlapping wage contracts traditionally are signed at Regional Labour Courts, once every twelve months, at a specific date for each industry grouping. According to the formula, the wage readjustment would result from the sum of three parcels. The first one provided for a wage hike equal to 50 per cent of the cost-of-living increase in the previous two years. This would bring the real value of the wage at the time of the readjustment to its average real value during the previous two years. The second part consisted of an additional wage hike equal to 50 per cent of the inflation predicted for the coming year. If the prediction were fulfilled, this would insure the maintenance in the following year of the same average value for the real wage as in the previous two years. The third part consisted of a wage bonus corresponding to the yearly increase in aggregate labour productivity. This was meant to guarantee the constancy of the wage share in GNP.

Such was the theory. In practice, during the 1964-68 period, when inflation has higher, the government predictions consistently fell short of realized inflation values. Eventually, as the inflation rate receded, an adjustment factor was added to the formula to compensate for the previous year under prediction of inflation. After November 1974, the formula started allowing for the reestablishment of the average real wage in the previous 12 months, instead of the previous 24 months. However, the labour productivity allowance continued to be authorized with much lower values than the growth of GNP per capita. According to one calculation, a fair application of the mathematical formula up to 1973 would result in a minimum wage rate 38 percent higher than the value that was in fact decreed by the government². Some wage drift did occur but not at a sufficiently high rate to compensate the wage earners for their real income losses under the government wage policy³.

² Cf. Lívio de Carvalho, "Políticas salariais brasileiras no período 1964-81", *Revista Brasileira de Economia*, 36(1), Jan/Mar 1982, pp. 51-84.

³ For an attempted measure of the wage drift above the minimum wage and a discussion of the role of the wage policy on income concentration in Brazil during the 1960s, see Edmar Bacha and Lance Taylor, "Brazilian income distribution in the 1960s: "facts", model results and the controversy *Journal of Developing Countries*, 14(3), April 1978; reproduced as Chapter 10 in Lance Taylor et al., *Models of Growth and Distribution for Brazil* (Oxford University Press, 1980).

4. 1979: Inflation Acceleration and New Wage Policy

A deep fiscal reform was put into effect in 1964-67, allowing the Federal Government to balance its regular budget without expanding the money supply. Rather than taking this opportunity to force inertial inflation down, the Government chose to pursue a passive monetary policy, using the “inflation tax” to provide cheap credit for additional public and private sector activities. The mandatory wage policy previously described made this growth-oriented policy compatible with a significant reduction of inflation after 1964. In fact, inflation was brought under control and kept at a rate of about 20 per cent a year during the “Brazilian economic miracle”, when GNP growth rates averaged 11 percent a year. The first oil shock hit the Brazilian economy at the top of the boom. The increase in the prices of oil and other tradable products resonated with the domestic indexation schemes, forcing Brazilian inflation towards a new plateau of 40 per cent a year in the 1974-78 period⁴.

During 1979, the Brazilian economy suffered a series of adverse cost pushes. Under the pressure of the US government, early in 1979 the Brazilian government started phasing out its industrial export subsidies program. As a compensation to exporters, this was accompanied by an acceleration of the rate of mini devaluations. In mid-79, the second oil shock started hitting at a time when a third consecutive poor annual harvest made its way to local markets. As inflation began accelerating, labour unrest became more pronounced. Mario Simonsen, since March 1979 the minister in charge of economic affairs, concluded that he did not stand a chance of implementing a stiff monetary policy under such conditions, and resigned his post in August. The animal spirits of the local bourgeoisie reached euphoria when General Figueiredo announced that Delfim Netto, the architect of the “Brazilian economic miracle”, would replace Simonsen. Entrepreneurial delirium became manifest when Delfim Netto suggested that he would fight inflation by raising production, and buried his predecessor’s plans for monetary control.

Meanwhile, in order to appease the labour movement, the Labour Minister, Murilo Macedo, conceived a new wage policy which received Congressional approval and was put in practice by the Government in November. The new wage law encompassed several changes. First, the system of annual wage adjustments was replaced by one of half-yearly wage changes. Second, the wage formula was eliminated, and wage indexing started to be based on a new price index, the National Index of Consumer Prices (INPC), using a nation-wide sample. This meant that projected inflation ceased to have an effect on legal wage readjustments. Third, the new wage law introduced an element of income

⁴ For an overview of the period, see E. Bacha, “Selected issues in post-1964 Brazilian economic growth”, Chapter 2 of L. Taylor et. al., *Models of Growth and Distribution for Brazil* (Oxford University Press, 1980), pp. 17-48. Relevant econometric evidence is presented in Francisco Lopes and André Lara-Resende, “Causas da recente aceleração inflacionária”, *Pesquisa e Planejamento Econômico*, 11(3), December 1981.

redistribution by guaranteeing higher adjustments for lower wage groups⁵. The new law also provided for an additional adjustment for productivity increases to be negotiated annually between management and labour. Finally, in order to speed up the transition to half-year indexing, an immediate 22 per cent wage bonus (corresponding to one-half of the annual wage adjustment of November) was decreed for workers whose annual settlement dates fell between December 79 and May 80 (at the corresponding dates, these workers now would receive a six-month wage adjustment).

This form of switching over to six-month wage indexing gave an additional impetus to inflation. But that still was not the end of the story. For in December, Delfim-Neto decided on a 30 per cent maxi-devaluation, accompanied by an elimination of tax credits granted to industrial exports and of advance import deposit requirements.

The resulting actual trade balance devaluation was in the order of 16 per cent, hence providing a final boost to inflation⁶.

At year-end, the 12-month inflation rate reached the 80 per cent mark. A quickening of monetary expansion in December guaranteed ample liquidity to validate the doubling of the inflation rate between 1978 and 1979.

5. Delfim Netto's Strategy Through Mid-1980

There has been no unambiguous statement of short-term economic policy coming from Delfim Netto since he began his term as economic czar in August 1979. In retrospect, his initial policies do not seem to add up to a consistent package, but an attempt can be made at understanding what his intentions were, previously to steering towards a monetarist policy course in the second half of 1980.

Delfim Netto seems to have diagnosed correctly the reasons why inflation *began* to accelerate in 1979, namely, the speeding up of the mini-devaluations and the continuing poor performance of domestic agriculture. He seems to have hoped to reduce inflationary pressures by slowing down the rate of devaluation *after* December 1979 and by promoting a "super-harvest" in 1980 mostly through minimum price guarantees and an extended subsidized agricultural credit program. Betting on this possibility, in early January 1980 he prefixed in 40 per cent the rate of devaluation through December.

Attempting to influence inflationary expectations, he further prefixed in 45 per cent the annual

⁵ Initially, the wage law guaranteed adjustments of 110 percent the rate of inflation for earnings up to three minimum salaries; earnings above 3 but below 10 times the minimum salary was to be adjusted by the rate of inflation; those above 10 but lower than 20 minimum salaries by 80 percent of the inflation rate, and those above 20 minimum salaries by one half the inflation rate. And the average adjustment implied by this formula was somewhat above the inflation rate, in December 1980 there was a modification to the law. Two brackets were created, from 10-15 and from 15-20 minimum salaries, to which adjustment factors of 80 per cent and 50 percent, respectively, were to be applied. Adjustments for wages in excess of 20 minimum salaries were left to free negotiation between employer and employee.

⁶ Calculated from data in Alkimar Moura, "A política cambial e comercial no período 1974-1980", Relatório de Pesquisa nº 16. São Paulo: EAESP- FGV, 1981.

rate of “monetary correction”⁷. In anticipation of these measures, Delfim Netto used jawboning techniques to force private banks to reduce lending rates to the tune of 10 percentage points per year. Money supply targets and credit limits also were established, but at the same time open market policies were directed at keeping market interest rates at the level of about 45 per cent per annum.

Apart from his contradictory attempt at simultaneously controlling the growth rates of money and credit, and fixing interest rates, Delfim Netto’s strategy was marred by a misjudgement of the behaviour of critical variable which were not under his control. The first was the strength of the inflationary pressures built into the economy in 1979. In spite of interest rate Controls and the slowing-down of the devaluation rate, by mid-year Delfim Netto’s prediction of 12-month inflation was already been reached at the Wholesale price level. The government also seems to have underplayed OPEC’s resolve to increase oil prices and Volcker’s intent and ability to reduce US money supply growth, with its consequences for the level of dollar interest rates. As a result of these events, by mid-year Brazil had accumulated a \$6.8 billion current account deficit in spite of a good export showing⁸. Finally, Delfim Netto overestimated his trump cards with the International banking community, and it was their unwillingness to bank his unorthodox policies that finally forced him into a complete policy reversal.

6. 1980: Foreign Exchange Shortage and Policy Reversal

Early in 1979 Brazil still had an oversupply of foreign exchange and the Central Bank was busily trying to keep foreign financial capital from flowing into the country. Official foreign reserves then began to fall as the mini-devaluations accelerated after March and domestic interest rates Controls were imposed after August. Over the year the Central Bank lost some US\$3 billion in convertible foreign exchange but in December it still displayed a foreign reserve balance of US\$ 9.7 billion, more than enough to pay for a half-year import bill.

As described in *Euromoney*⁹, the Brazilian government then started playing “a cat and mouse game” with foreign bankers, refusing to accept the higher spreads that the market demanded, as Brazilian economic situation deteriorated and confidence on Delfim Netto’s policies disappeared. As shown in Figure 1, convertible foreign exchange reserves fell abruptly during the first half of the year, from \$8.3 billion in December 79 to \$4.8 billion in June 80. The sharp reserve losses harmed the creditworthiness of the country, reinforcing the banks desire to hold off from Brazilian deals. The

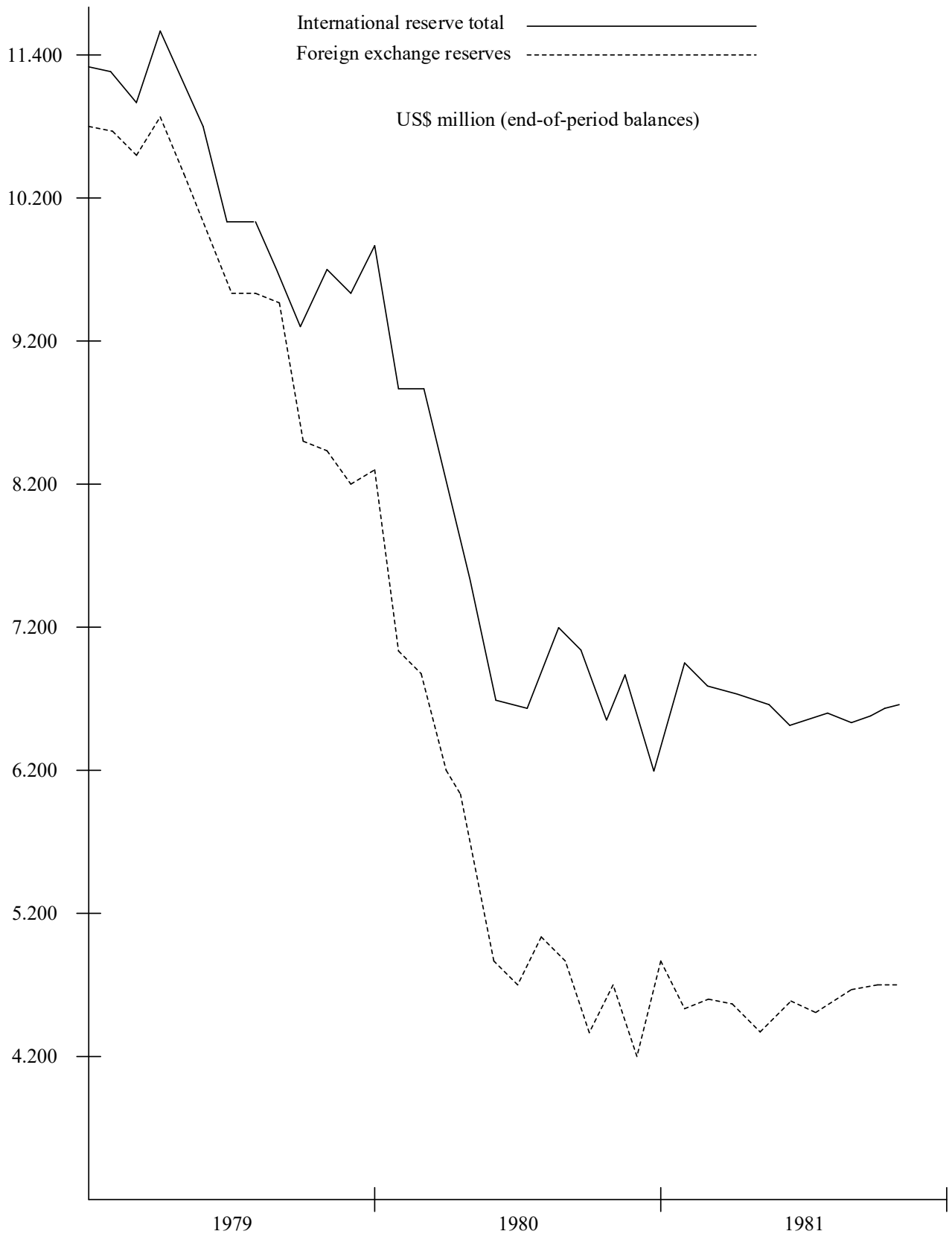
⁷ “Monetary correction” is an indexing scheme for a number of financial assets, housing rents and mortgages, tax debts etc.

⁸ This compares unfavourably with a \$4.5 billion deficit during the first half of 1978.

⁹ Peter Field and Steplen Downer, “Brazil’s rescheduling: this year, next year, sometime, never?” *Euromoney*, October 1980, pp. 89-98.

feeling spread in the market that Brazil would be forced to reschedule its commercial debt in 1981, and in private meetings US bankers started urging Brazilian officials to go to the IMF to clear up the air.

Figure 1



Rather than going to Washington, Delfim Netto chose to undo in Brasilia his past policies. New “monetary correction” (of 50%) and devaluation targets (of 45%) were announced for the July 1981 – June 1982 period, as a means of loosening the values previously fixed for December 1981 without losing much face. Interest rates were let to creep upwards and Controls over money and credit tightened. A 25% tax on domestic borrowing was introduced in May with the triple purpose of restricting credit demand, inducing local firms to borrow abroad and diminishing the size of the budget deficit. Centralized Controls were established over the expenditure plans of state enterprises.

These measures of mid-80 proved insufficient for the task at hand: during the third quarter, inflation continued to accelerate and the current account to deteriorate. When foreign exchange reserves threatened to dry up, officially nearly going under the \$4 billion mark in November, Delfim Netto gave up, decontrolling domestic interest rates and cancelling the prefixation of monetary correction and devaluation rates.

7. 1981: Industrial Recession

During the following months, Delfim Netto implemented the tightest monetary policy that the country has experienced since Joaquim Murinho failed in his utopic attempt at reestablishing the pre-Republican sterling parity at the turn of the century. Correspondingly, Brazil witnessed one of the deepest industrial slumps in its statistically recorded history.

The evolution of real money supply, real ex-post interest rates, and industrial output are displayed in Table 1 on a quarterly basis for 1979 to 1981. The behaviour of interest rates clearly indicates the alternating pattern of Delfim Netto’s monetary policies: very loose from mid-1979 to late 1980, followed by extreme tightness until the end of 1981. The differences between 1980 and 1981 in real interest rates on consumer credit are astonishing, but then the rates for 1980 may understate true costs for the borrower, as controls prevailed and thus rate reporting to the Central Bank may have been biased downwards. The magnitude of policy reversal is indicated by the behaviour of real interest rates on 3-month government bills. From a negative 40 per cent in the first half of 1980, they rise steadily to become positive in the second half of 1981.

Real money stock which was kept constant during 1979, was already falling in the first half of 1980. But this did not affect short-term interest rates, as inflation acceleration certainly reduced real money demand. The liquidity crunch picks up towards the end of 1980 to acquire unheard of proportions half-way through 1981. At the height of the crunch, in the second quarter of 1981, the money stock in real terms was made nearly 30 per cent lower than a year before. The response of industrial production to such powerful money contraction and accompanying sky-high interest rates is shown in the last column of the table. Yearly industrial growth rates, already null in the beginning

of 1981, became increasingly negative during the year. The last recorded figure, for the last quarter of 1981, register for industrial production a value 16 per cent lower than in the previous year¹⁰.

On a 12-month basis, inflation rates peaked in the first quarter of 1981 and then started to decline, as shown in Table 2. A two-way decomposition of the aggregate index indicates that inflation reduction was associated with a significant deterioration of agricultural terms of trade; in the last quarter of 1981 industrial price inflation was only 10 percent lower than in the corresponding period of 1980. Ironically, Delfim Netto obtained the inflation deceleration that he had hoped for, through the “super-harvests” that he had planned¹¹ – but then, one year too late to justify his heterodoxies.

¹⁰ An on-going revision of industrial statistics suggests that the above figures may exaggerate the extent of the industrial slump in 1981. On the basis of the data in Table 1, the Brazilian national accounts reported initially that industrial output had fallen by 8.4 percent between 1980 and 1981. In a recent revision, this negative change was reduced to 5.4 percent Cf. *Conjuntura Econômica*, 36 (5), May 1982.

¹¹ According to the national accounts, the growth rate of agriculture was 6.3% in 1980 and 6.8% in 1981.

Table 1
Brazil: Money, Interest and Industrial Production, 1979-81
(Quarterly averages)

Period		Real Money Supply (1978 =100)	Real Ex-post Annual 3-month government bills	Interest Rates 6-month consumer credit	Industrial Production (1978 =100)
		(1)	(2)	(3)	(4)
1979	I	100.0	-6.8	11.5	100.0
	II	98.4	-16.6	-5.4	106.9
	III	97.3	-35.6	-14.9	111.2
	IV	98.1	-36.9	-13.5	110.9
1980	I	89.8	-41.7	-20.4	107.9
	II	89.8	-47.7	-21.7	111.8
	III	79.4	-39.1	-14.1	122.6
	IV	77.0	-26.9	6.6	117.8
1981	I	65.5	-18.1	43.7	106.0
	II	62.1	.7	46.6	104.4
	III	59.9	1.5	52.6	106.4
	IV	65.8	2.0	n.a	99.2

Notes: (1) Quarterly averages of M_1 deflated by the wholesale price index of Conjuntura Econômica (Column 2).

(2) Obtained as quarterly averages of $[\frac{(1+i_t)}{1+p_t}]^4 - 1$, where i_t is the 3-month interest rate on LTNs auctioned in the primary market at month t and $p_t = \frac{p_{t+3}}{p_t}$, where p_t is the wholesale price index from month t . The interest rate on LTNs are calculated from the discount rates, d_t , published by the Central Bank according to the formula $i_t = \frac{1}{1-.25d_t}$.

(3) Quarterly average of $(\frac{1+i_t^*}{1+p_t^*})^2 - 1$, where i_t^* is the 6-month lending interest rate of São Paulo finance companies at month t , and $p_t^* = \frac{p_{t+6}+6}{p_t}$, where p_t is the wholesale price index for month t .

(4) "General indicator" of industrial production from the Brazilian Institute of Geography and Statistics (IBGE).

The resilience of industrial price dynamics, in face of such deep reduction in real aggregate demand, testify to the rigidity of mark-up pricing rules in modern Brazilian industrial structures¹².

This inflexibility is compounded in the Brazilian case by a mandatory wage readjustment scheme at fixed intervals, which is entirely dependent on past, not future inflation. Additionally,

¹² For alternative tests of the hypothesis of mark-up pricing in Brazilian manufacturing, see A. Lara-Resende and F. Lopes, "Sobre as causas da recente aceleração inflacionária", and C. Considera, "Preços, mark-up e distribuição funcional da renda na indústria de transformação", both in *Pesquisa e Planejamento Econômico*, 11(3), December 1981.

according to some calculations, the redistributive principle built into the 1979/80 wage policy implies that the average wage readjustment is mildly over 100% of past cost-of-living increases¹³.

If the impact of tight money on industrial wage-and-price dynamics was tenuous, its effect on the balance of payments was much clearer. In 1981 the import quantum was 13 percent lower than in the previous year, whereas the export quantum was 20 per cent higher. Thus, in spite of a 15 per cent terms of trade loss, the trade balance turned from a negative \$2.8 billion in 1980 to a positive \$1.2 billion in 1981. Higher domestic interest rates also induced the private sector to go abroad for funds, thus lessening the burden on the public sector to generate through its state enterprises the financial inflows required to cover the current account deficit.

Table 2
Brazil: Inflation Rate Indexes
(Yearly Rates: quarter of this year over same quarter of previous year)

Period		Wholesale Prices Overall Index	(Aggregate Supply) Industry	Agriculture
1979:	I	44.5	43.0	47.4
	II	46.9	47.0	46.3
	III	56.0	56.8	54.0
	IV	72.1	71.5	73.3
1980:	I	86.5	84.1	91.3
	II	99.0	98.8	98.3
	III	113	112	115
	IV	119	113	134
1981:	I	122	118	132
	II	121	117	130
	III	106	108	101
	IV	94.0	102	77.0

Note: These indexes are derived from columns 3,17 and 26, respectively, of *Conjuntura Econômica*, various issues.

This confirms that a recession at least temporarily improves the trade balance. But the question remains whether such improvement can be maintained once the economy recovers. For a primary exporting country, the traditional structuralist answer is in the negative. But for a semi-industrialized country like Brazil, it may be case that the unused capacity generated by lack of domestic demand under pressure can be made suitable for import substitution and/or export expansion. In this case, a

¹³ See A. Baumgarten Jr., "A aritmética perversa da política salarial", *Revista Brasileira de Economia*, 35(4), Oct./Dec. 1981.

temporary recession may permanently improve the balance of payments. Empirical evidence for this optimistic hypothesis is scanty¹⁴.

8. Two Views on Stabilization Policies

We proceed to evaluate Delfim Netto's decision not to go to the IMF and if this was a sensible thing to do. As a starting point, a short statement needs to be made to distinguish in a necessarily stereotyped fashion between two visions of stabilization policies in a semi-closed economy like Brazil. For brevity, one is identified as "neo-classical" and the other, as "heterodox".

Neo-classical orthodoxy on stabilization policies asserts that: (1) inflation and current account deficits are symptoms of excess domestic demand over full-employment output; (2) over the medium-haul, a contraction of domestic demand does not affect the level of real output; and (3) with adaptive expectations short-term rigidities in the price mechanism, it is inevitable that a contraction of domestic demand will temporarily reduce the level of employment. Within the orthodox field, "Keynesians" see gradualism in demand contraction as the best way to deal with the last set of problems, whereas "monetarists" on a number of grounds still prefer a shock treatment type of stabilization package. Both camps, however, tend to view the reluctance of domestic residents (who previously enjoyed excess absorption) in accepting to live according to their own means as the basic political difficulty to be faced by a stabilization program.

At least in Brazil, heterodoxy would diverge on three counts: (1) full-employment is not the natural State of the economy, but a consequence of the level of aggregate demand; (2) imports are mostly complementary to domestic production, and the growth of exports is limited by price-inelastic foreign demand not so much by the pressure of domestic demand on capacity; and (3) Brazilian inflation is mostly inertial – the result of mark-up pricing and wage reaction functions – and it fluctuates mainly according to the direction and intensity of the supply shocks experienced by the economy. According to this view, a contraction of domestic demand affects mostly the level of employment, and thus the current account as it reduces complementary imports – but it does not directly change the rhythm of inflation or improve the current account at a full-employment level. This view implies that money should be passive during a stabilization program, with its rate of growth declining *pari-passu* with, but never anticipating the reduction of inflation. The active stabilization policies supported by the heterodoxy are necessarily more structural-oriented and state-interventionist than in the neo-classical case. To make the full-employment trade balance more sensitive to domestic demand Controls, domestic production and exports need to be made more

¹⁴ For a theoretical discussion, see E. Bacha, "Growth with limited supplies of foreign exchange: a reappraisal of the two-gap model", in M. Syrquin, L. Taylor and L. Westphal (eds.), *Economic Structure and Performance*, forthcoming.

similar to foreign supplies, and this presumes both maintenance of investment and a movement towards industrial diversification. Inflation reduction can be achieved by productivity increases or by alternative incomes policies, the specification of which would vary according to the political milieu.

9. Delfim-I: IMF Would be Better?

The evidence is abundant that Delfim Netto's conception of stabilization policies is much closer to heterodoxy, as previously defined, than to neoclassical orthodoxy¹⁵. IMF thinking, on the other hand, even under its recent conversion to gradualism, clearly classifies as orthodox¹⁶.

In the case at hand, however, it can be argued that an early intervention of the Fund might have avoided the policy blunders that Delfim Netto committed in 1979/80, and thus prevented a foreign exchange shortage from occurring in mid-1980. Delfim Netto entered the Planning Ministry with an apparent *carte-blanche* from the military establishment and the Brazilian entrepreneurial elite. But in fact he had to do something, not only different from Simonsen's but spectacular too. He then made the regrettable choices of stiffly controlling interest rates, maxi-devaluing in November 1979, and unrealistically prefixing the monetary correction factor and the devaluation rate for 1980.

The IMF presence might have forced Delfim Netto to be more modest in his policy objectives, maintaining the economy in slow gear as export promotion efforts progressed and import substitution projects matured. He then might have not embarked on a selective price control program, at a time when most other prices were getting out of hand. This plus the IMF stamp of approval might have preserved foreign bankers' confidence, even as inflation inevitably accelerated and the current account deteriorated in 1980. A foreign exchange shortage might not have occurred and consequently the shock treatment implemented in 1981 might not have been necessary.

But this is just a day-dream. First, because no one in Brazil was either pressing or even suggesting Delfim Netto to go to the Fund when he entered the Planning Ministry in August 1979. In fact, except for the financial sector, everyone that counted in the country was quite happy to see Simonsen's policies to be knocked out by Delfim. Second, because the odds are that the Fund would not approve the adoption of a passive monetary policy in 1979/80 and this was required to accommodate the underlying inflationary pressures, without provoking an earlier recession. Most likely the Fund would want to see Simonsen's monetary control policies put into effect as a pre-

¹⁵ See, for example, his critique of the Campos-Bulhões 1966 stabilization measures in "Análise do Comportamento da Economia Brasileira", working paper of the joint advisory group to the Ministries of Finance and Planning (Rio de Janeiro, mimeo, 1967), partly reproduced as an appendix to Ministério do Planejamento, *Diretrizes do Governo, Programa Estratégico de Desenvolvimento* (Rio de Janeiro, Departamento de Imprensa Nacional, 1967).

¹⁶ As a recent paper by Crockett makes clear, when the IMF staff worries about the supply side, their concern is with getting the prices right and promoting savings. This is not necessarily bad, but has little to do with the problems with which the heterodoxy is concerned. Cf. A. D. Crockett, "Stabilization policies in developing countries: sane policy considerations", *IMF Staff Papers*, 28(1), March 1981, pp. 54-79.

condition for a loan application. And this would only have anticipated for 1979/80 the economic crisis of 1981. The loss of production might have been less, but politically a voluntarily adopted contractionary policy could only be interpreted as a right-wing reaction against the new wage policy. This undoubtedly would jeopardize a pacific transition towards a more democratic order in Brazil. Delfim Netto's contractionary policies are not similarly stigmatized apparently because the body politic interprets them as being adopted out of necessity rather than as an act of choice.

10. Delfim-II: A Scenario for the IMF

These considerations relate to policy decisions taken from mid-79 to early-80. A different picture emerges when late-80 policies are considered. The country then was about to face a foreign exchange crisis and International bankers were pressing the government to go to the Fund. It is Delfim Netto's decision of not doing this that needs an evaluation.

Adopting the Guitian-Williamson standards of measurement approach for assessing policy measures and results¹⁷, we need to imagine what actions would have taken place as a result of a Fund supported adjustment program. According to informed sources, the IMF board was quite happy with the monetary policies adopted by Delfim Netto in 1981, considering that this was exactly what the country needed. There is no question of them judging monetary stringency in 1981 as excessive. However, the Fund apparently would like stiffer fiscal policies to be implemented, particularly concerning the subsidized credit programs. Additionally, the new wage policy is considered to be an impediment to inflation abatement and it is likely, for example, that the IMF staff would find it suitable a reduction of the wage readjustment currently benefitting lower salaries, from 110 to 100% of past inflation.

Fiscal deficit and wage policy are two complicated and sensitive issues with which the government is unlikely to deal before the November 1982 elections. In order to simplify the alternative scenario, perhaps unrealistically we will assume that the Fund would accept a postponement of these two problems, and would file in Brazil's loan application simply on the basis of the stabilization policies actually implemented in 1981.

The unemployment and output losses would then be the same. The balance of payments in current account, however, might be favourably affected. First, because the interest charges on Fund loans would be lower than market rates. Second, because spreads on Eurodollar loans to Brazil might have been less than the country is currently paying. It is hard to know much less, but a start can be made in this direction calculating how much higher the Eurodollar spreads on Brazil loans became

¹⁷ Cf. M. Guitian, "Economic management and Fund conditionality", mimeo, 1981; and J. Williamson, "On judging the success of IMF policy advice", mimeo, 1981.

between 1979/80 and 1981. According to the Central Bank, in 1981 the average spread on syndicated loans to Brazilian state enterprises was $2\frac{1}{8}\%$ over Libor or 2% over US prime, with a flat fee of $1\frac{1}{2}\%$ ¹⁸. At the end of 1979, Euromoney reports that Brazil was paying a spread of $5/8\%$ over Libor with a flat of $11/16\%$ ¹⁹. By mid-80, according to this source, spreads had risen to $1\frac{1}{2}\%$ over Libor plus a front-end of $1\frac{1}{8}\%$.

We will assume the following: (1) the spread increases from 1979 to 1980 would occur with or without the Fund presence, as a result of inflation acceleration and balance of payments deterioration; (2) the spreads of 1980 would have been kept constant in 1981 if Brazil had gone to the IMF as bankers wanted; and (3) the rate differentials quoted above for syndicated loans apply to all Brazilian deals in the Eurodollar market.

Two important qualifications due to Batista Jr. need to be added before figures are presented²⁰. First, it was only in 1981 that the US prime rate started to appear frequently in Brazilian loans as an optional reference rate for banks to charge their spreads. During that year, the US prime (Citybank) on average was $2\frac{1}{8}$ percentage points above Libor²¹. Second, in some recent deals Brazilian State enterprises have accepted the payment of interest charges on a quarterly basis, rather than on a semi-annual basis as before. With annual interest rates in the neighbourhood of 20 per cent, this practice increases the yearly spread in about 1 percentage point.

Ignoring these two qualifications, in 1981 Brazil would have paid spreads over Libor $5/8$ percentage points higher than in 1980. When they are taken into account, the difference rises to $3\frac{5}{8}$ percentage points. Unfortunately, these cost estimates are far apart, but we are unable to tell how much of the gap between them is due to an effective increase of the “Brazil risk” or to a general worsening of credit conditions in the Euromarket in 1981. For lack of more precise information, we will consider the shift to 3-month compounding of interest as a reflection of a general worsening of credit conditions in 1981, and will take one-half of the difference between Libor and Prime as reflecting an increase of the “Brazil risk”. This means taking the value of $1\frac{11}{16}$ (percentage points per year) as our estimate of the spread improvement that would have taken place in case Brazil had gone to the Fund in 1981²².

¹⁸ Banco Central do Brasil, *Informativo Mensal*, 2(18), January 1982, p. 12.

¹⁹ Cf. P. Field and St. Dwyer, *Op. Cit.*, pp. 91-2.

²⁰ Cf. Paulo Nogueira Batista Jr., “O custo financeiro da dívida externa em 1981” (Centro de Estudos Monetários e de Economia Internacional, Fundação Getúlio Vargas). Rio de Janeiro, *mimeo*, September 1981.

²¹ For lack of information, we ignore the problem posed by the fact that Libor seems to be charged at its value in the beginning of the period, whereas the prime tends to be computed at its value in the end of the period (with the relevant period varying from 3 to 6 months, depending on the credit contract).

²² This figure should be multiplied by the ratio $1.0150/1.0125 = 1.002$ to reflect the deterioration in flat fee charges between 1980 (when that fee was $1\frac{1}{8}$) and 1981 (flat fee equal to $1\frac{1}{2}$). Due to our rounding procedures, this correction does

On balance of payments basis, Brazil contracted \$16.7 billion in the Euromarket last year. Out of these, the size of Brazil's quota and the recent Indian deal suggest that \$1.5 billion could be had from the Fund at an interest rate of 12 percent a year or 7 percentage points less than the market rate²³. The remaining \$15.2 billion would have cost Brazil $1\frac{11}{16}$ percentage points less in spreads. Savings in the IMF loan would amount to \$105 million, and in market loans to \$256 million – adding up to a difference of \$361 million in total interest costs.

This represents only 1.7 percent of Brazilian exports in 1981, but one needs to take into account that economic activity in the country clearly was constrained by the supplies of foreign exchange. This means that the marginal social value of one dollar was much higher than its market value. How much higher is anybody's guess, but a rough idea can be obtained as follows. Consider the expression:

$$B = NX(Y) + F$$

where B is the balance of payments; Y is national income; NX , the trade balance; and F stands for all other autonomous International transactions. If B is constrained to be equal to zero, then:

$$\left. \frac{dY}{dF} \right|_{B=0} = \frac{1}{n}$$

where n is the marginal propensity is import minus the “marginal propensity to export” (presumably, a non-positive value). Now, n is considerably lower than unity, in fact, it is difficult to imagine it to have a value higher than $\frac{1}{4}$ in Brazil. Hence, we need to multiply the US\$ 361 million by a factor of 4 to get at a figure comparable to Brazilian national income, which was about US\$250 billion in 1981. The conclusion is that the dollar savings in interest charges would have represented something like 1/2 percent of Brazil's GNP in 1981.

This balance of payments gain has to be weighed against its cost for the government, i.e., the loss of flexibility to change economic policies at will during a three-year period. From a heterodox point of view, this may be deemed a real cost, as the Fund would want to keep monetary stringency far longer than Delfim Netto, because for him the 1981 monetary package is an emergencial measure, whereas the IMF would want to implement it on the belief that this was the best policy course for the country to take. The nature of the impasse is previewed by the current debate on “excessive” monetary expansion in the first quarter of 1982. This debate will become hotter as the November elections approach. It is certainly to the benefit of all concerned that the IMF is not openly involved in this particular imbroglio.

Things may change after the election, if – following the example of Spain – the government negotiates a Moncloa Pact with the opposition. Terms could then be worked out to ensure that the

not show up in the results.

²³ The market rate is calculate as the sum: $16\frac{5}{8}$ (average value of Libor in 1981) + $2\frac{1}{8}$ (nominal spread over Libor) = $18\frac{3}{4}$ x 1.015 (correction for the flat fee of $1\frac{1}{2}$) = 19.

1964-74 wage crunch would not be repeated. In this case, labour leaders might be willing to accept changes in the new wage policy leading to disinflation²⁴. A political compromise regarding the degree of public sector intervention in the economy also needs to be worked out, providing adequate financing for government expenditures. Brazilians then would have to make up their minds on whether they want to face the Herculean task of convincing the Fund that a passive monetary and credit policy is a necessary ingredient of a correct stabilization policy for their country.

²⁴ The endogeneization of the wage settlement period, making it dependent on the accumulated rate of inflation, is a politically attractive alternative, since it is part of the economic program of the main opposition party. For a theoretical analysis, see Pécio Arida, "Reajuste salarial e inflação: uma sugestão de política econômica", in *Pesquisa e Planejamento Econômico* 12(2), August 1982.