The foreign debt hits home

TRADE & JOBS: THE BRAZILIAN CONNECTION

by Marc Levinson

"Borrowers should pay their debts." Most Americans would agree with this maxim and would probably apply it to debtor countries as well. There is little sympathy in evidence for the debtors, and even less for the money-center banks whose capital is badly at risk in Latin America. The discussions of such esoterica as International Monetary Fund loans, special drawing rights, and debt refinancing bring yawns. Undoubtedly, the Reagan administration's view that debt is a private matter, to be resolved between debtor countries and their creditor banks, enjoys wide public support.

From that perspective, the solution to the debt crisis is trade. By selling their products in Europe, North America, and Japan, the debtor countries will be able to earn the foreign exchange they need to pay their debts. "The greatest thing we can contribute now to helping them in their problems is to do everything we can to ensure and increase, if possible, the economic recovery that is now taking place," said President Reagan on May 31. In the summer issue of *Foreign Affairs*, William E. Brock, the president's special trade representative, called for a new round of international trade negotiations that would, among other things, guarantee open markets for less-developed countries. Brock said nothing more about dealing with the debt.

Superficially, this approach appears to be successful. Under pressure from the banks and the International Monetary Fund, one Latin American country after another has agreed to austerity programs involving budget cuts, slower monetary growth, fewer subsidies, and more exports. In each case the result has been recession. Real wages have fallen. Demand for imported goods has plummeted. Exports have boomed. All the major debtor countries—Argentina, which has been most resistant to demands for austerity, Venezuela, Mexico, and Brazil—have positive trade balances to show for their efforts, and all but Argentina have kept up to date on the interest they owe on their debts.

These heroic efforts have added much to the profits of international banks, which earn far more on their Latin American loans than on normal commercial loans. They have, however, been of little benefit to workers in the industries of developed countries. Along with the Latin American workers who have seen their incomes devastated by the effects of austerity, it is the steel workers of Gary, the textile finishers of Greenville, and the poultry farmers of Arkansas who have borne the brunt of a policy that takes the debt payments as a given and requires huge trade surpluses in order to make them.

CASE IN POINT

No country illustrates this effect on American workers better than Brazil. With the world's eighth largest economy, Brazil is by far the most industrialized nation in the developing world. With foreign obligations of $100 billion, it is also the most in debt.

Brazil has traditionally been a minor participant in international trade. While the profits from coffee and sugar exports fueled the country's initial industrialization in the 1930s, the industries themselves served primarily domestic markets. With a complex set of government policies to guarantee high prices for Brazilian manufacturers—sugar, for example, may be sold only in cotton bags, to maintain demand for Brazilian cotton; diet soft drinks may not be sold at all, to keep up the market for refined sugar—manufacturers saw little sense in selling abroad for less than they could earn at home. "We only sell our surplus abroad," advises an officer of a major alcohol exporter. "The government guarantees us a higher price domestically, so we sell as much as we can here."

As recently as 1978, Brazil's exports totalled only $12.7 billion, barely 6 per cent of its gross national product—half the U.S. proportion and less than one-fifth that of many European nations. In that same year, imports totalled $13.7 billion, creating a trade deficit of over $1 billion. Such a deficit was not unusual: Except for tiny surpluses in 1973 and 1977, Brazil ran a trade deficit every year from 1972 to 1980. Depite an inflow of foreign capital, those annual trade deficits increased Brazil's foreign debt from $5 billion in 1972 to $46 billion in 1980.

As the magnitude of the debt problem became clear, the attitude toward foreign trade changed rapidly. The Brazilian Government began pushing exports and developed an imposing array of export-subsidy programs. At the same time, due in part to the IMF demand that the government act to slow inflation, the economy was thrown into reces-

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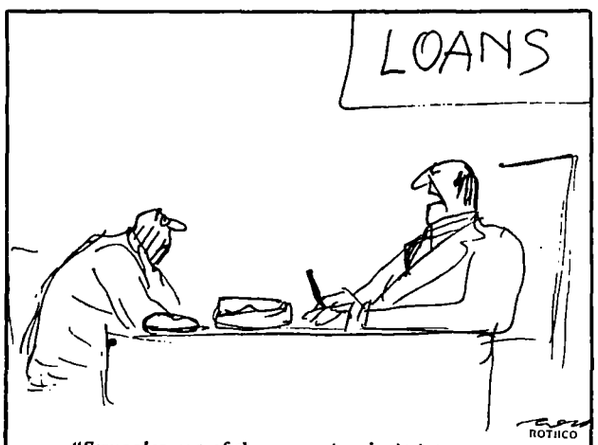
sion. Industrial production collapsed. Output of steel plates dropped by a third from 1980 to 1982. Automobile production dropped by 20 per cent and tractor production by more than half. Industrial employment fell by 15 per cent in two years and has continued to fall: The number of people employed in Brazilian industry today is only 80 per cent of what is was four years ago. Demand for consumer goods declined accordingly. Brazilian manufacturers quickly figured out that if they were to survive, they had to sell abroad.

The effects have been startling. In 1984, Brazil is expected to export goods valued at over $26 billion, twice the level of 1978. Ten per cent of its gross national product comes from exports, a proportion similar to that of the U.S. At the same time, the composition of Brazil's exports has changed dramatically, away from traditional agricultural staples and toward processed goods. While the dollar value of nonindustrial exports grew 23 per cent from 1978 to 1984, the value of industrial exports *doubled,* and the quantity *tripled.* Although coffee and iron ore remain the two largest export items, all of Brazil's other leading exports are manufactured goods, such as steel products and transportation equipment, or processed agricultural goods, such as soy meal and frozen orange juice concentrate. Fully two-thirds of Brazilian exports are now manufactured or semi-manufactured goods.

Imports have gone in the other direction. After peaking at $23 billion in 1980, imports are expected to total less than $15 billion this year. From 1983 to 1984 alone, Brazilian exports have climbed 24 per cent, while imports have fallen 10 per cent. In addition to the traditional system of tariffs and import prohibitions (some two thousand items may not be imported into Brazil because a "similar" item is produced locally), firms wishing to import must first obtain a quota entitling them to import (the size of which depends on previous years' imports) and then obtain a license from the Foreign Commerce Section of the Banco do Brasil, which hands out licenses only if it feels the imports are necessary and if foreign exchange is available. Even with a license, importers must buy dollars from the Banco do Brasil at a price 25 per cent higher than the official rate, providing further disincentive to import.

As the country's largest trading partner, the United States has borne much of the impact of this change in Brazil's trading patterns. About $9 billion of Brazil's exports this year are headed for the United States, while the U.S. will sell only about $2.3 billion worth of products in Brazil. U.S. exports to Brazil are nearly 20 per cent less than they were six years ago, and our major export is one that keeps few U.S. factory workers busy—raw wheat.



"Struggles out of the quagmire don't interest me. Struggles to the top do!*"*

This export-at-all-cost strategy has high costs for Brazil. Keeping exports high means keeping the cruzeiro cheap. "Minidevaluations" occur as often as three times a week, in line with domestic price increases, thus keeping prices roughly constant in dollar terms despite Brazil's 230 per cent inflation. A "maxi" devaluation, which would counter the effects of the strong dollar on Brazil's exports to Europe and Japan and would make Brazilian goods even cheaper in the U.S., is widely expected. These devaluations, in turn, add fuel to the inflationary fires. Wage increases are held to 80 per cent or less of the rise in consumer prices, meaning a continuing loss in real income for Brazilian workers. The dollar value of the monthly minimum wage set by the government, to which all industrial wages are pegged, dropped from $93.74 in December, 1982, to $46 by August, 1984, at official exchange rates.

In 1984, at least, this emphasis on exports may prove sufficient to allow Brazil to meet interest payments on its foreign debt. With strenuous effort, the expected trade surplus is about $12 billion. While this will cover the $11 billion in interest due this year, it will not pay the additional $4 billion needed to cover freight, royalties, dividend payments, the cost of maintaining diplomatic missions, and other essential expenditures. As a result, Brazil's foreign debt will continue to mount.

OF ORANGE JUICE AND CARBON STEEL

The transformation of Brazil's trade patterns from those of a less-developed country to those of an industrialized state has caused profound disquiet on the part of the United States. Brazilian steel is used in U.S. buildings. Brazilian shoes are on sale in every American discount store. Brazilian aluminum may soon begin to flood the U.S. Brazilian chickens are challenging U.S. leadership of the frozen-chicken markets in Japan and the Middle East. In response, despite the free trade rhetoric of top officials, various organs of the U.S. Government have erected a protectionist fence.

Traditionally, Brazilian exports have met little resistance in the United States. Since only a small amount of coffee is grown in this country, Brazil's major export caused no trade frictions. Sugar, another long-time export, was largely governed by quotas designed to protect U.S. growers—quotas which suited the Brazilians fine, since they guaranteed high prices. Besides textiles, which are subject to a complicated worldwide quota arrangement, few Brazilian export products faced U.S. restrictions prior to 1982. Leather shoes, the subject of a 1974 complaint by U.S. shoe manufacturers, faced special surtaxes totalling 20 per cent, while ethyl alcohol, a fuel additive, was subject to a ten cent per gallon import surcharge starting in 1980.

In the last few years, however, the list of Brazilian products sanctioned by U.S. authorities has expanded to include frozen orange juice concentrate, hydrogenated castor oil, printed vinyl film, leather handbags, leather clothes for men, scissors, cotton thread, pig iron, chromium iron, carbon and stainless steel machine thread, steel alloy bars,

laminated or galvanized steel sheets, steel or galvanized metal tubes, and steel alloy tools. In 1984 alone, the president has announced his intention to seek quotas on Brazilian carbon steel, while other metal products, such as welded steel pipes, tubes, tubular goods, iron bars, and steel wire strand, have been subject to federal investigations. Pressure on Congress from tobacco-state senators will lead to reductions of tobacco imports from Brazil in 1985, without administrative action.

In the international arena, the U.S. has asked for consultations with Brazil—the step prior to filing complaints with the General Agreement on Tariffs and Trade—on chickens, soybeans, soy meal, and soy oil. Recent changes in regulations concerning textiles and apparel imports, while affecting a large number of countries, will also hurt Brazil.

U.S. protectionist measures are given front-page prominence in the Brazilian press, and few Brazilians understand, or sympathize with, the economic dislocation their products cause in the United States. Brazilian government officials see the measures as the inevitable result of election-year politics in the U.S. "We believe that this is not the position of the American executive branch in regard to Brazilian exports, but nothing can be done to impede these protectionist actions in the U.S.," Carlos Viacava, director of the foreign trade section of the Banco do Brasil, told me recently in São Paulo. "The more Brazilian exports grow, the more reactions there will be. We are prepared to confront them, not just in the United States but in the rest of the world—ever-larger reactions, because we are increasing our participation in the market."

The heavy flow of Brazilian exports to the United States would not raise objections if the U.S. could sell products to Brazil in return. But efforts by U.S. negotiators have resulted in few gains. Traditional imports, such as spare parts for U.S.-made equipment, were restricted by Viacava's office to such an extent that Brazilian firms sprang up to supply many of the components; those firms are now demanding continued protection, and would-be importers are hedging their bets despite a need for higher-quality parts from abroad. As economist Antonio Carlos Porto Goncalves of the Fundação Getulio Vargas explains, "If you have a domestic supplier, keep it, because in the future they might control imports again and you'll have a problem."

Many key U.S. exports, such as computer equipment and software, can be imported into Brazil only in small quantities or, in the case of microcomputers, cannot legally be imported at all. Brazil's booming arms industry, one of the world's largest, has reduced the need for other traditional U.S. exports. And Brazilian internal politics keeps out still others. Despite Brazil's status as the world's lowest-cost shoe manufacturer, even shoe imports are banned. When the U.S. removed restrictions on leather shoes from Brazil last May, it asked in return that the Brazilians allow imports of U.S.-made golf shoes. According to officials at the U.S. embassy in Brasilia, the idea was given a quick thumbs down.

This lopsided trade pattern has had heavy costs for the U.S. According to frequently cited Department of Commerce statistics, each billion dollars of industrial exports creates 24,000 jobs in the United States. The drop in U.S. exports to Brazil, nearly all in the manufactured sector, has thus cost nearly 40,000 U.S. jobs since 1980. Applying the same rough estimate to imports, the growth of around $5 billion in manufactured imports from Brazil since 1980 has eliminated 120,000 jobs. The total U.S. loss, according to these approximations, is around 160,000 jobs.

And that calculation considers only Brazil. Almost every other country in Latin America is engaged in a similar crash export program to pay interest on its debts. From a $5.9 billion surplus in 1980, the U.S. balance of trade with Latin America fell to a $13.9 billion deficit in 1983. U.S. exports to Latin America fell by $21 billion from 1981 to 1983. If two-thirds of those exports were industrial products, that statistic alone would explain the loss of over 300,000 manufacturing and exporting jobs in the United States.

BUYING STABILITY

By taking the debt as a private affair and the need to meet interest payments as inviolate, the U.S. Government is profoundly affecting domestic welfare in the United States. Through the mechanism of trade surpluses used to make interest payments, income is being transferred from the manufacturing sector to the banking sector. In 1976 the three largest debtors—Argentina, Brazil, and Mexico—spent only a sixth of their available foreign exchange on interest; the rest was used to purchase imports. In 1983 the proportion was close to half. Dollars that could otherwise be used to buy products in the United States are instead being used to pay interest to U.S. banks.

This situation will continue in the foreseeable future. The debt burdens of major countries involved are growing, not shrinking. In the cases of Mexico and Brazil, it is the economy that has shrunk, making the debt an even larger portion of gross national product. Under present circumstances, repeated huge trade surpluses will be required if interest payments are to continue on schedule. Rescheduling does not change things by itself, because under a simple rescheduling plan, interest payments are not affected; only the principal is rescheduled. Even where interest payments are slightly reduced in the process of rescheduling, as was the case of Mexico in September, it is not clear that a small drop in interest rates will eliminate the need for huge Mexican trade surpluses.

There is no shortage of proposals to rearrange the debt crisis, most of them designed to protect the interests of American and European banks. But from the point of view of the United States, the stability of the banking system is only part of the problem. We are buying that stability at the cost of jobs. For workers in industry and agriculture, rearranging the principal is less important than sharply cutting the interest payments debtor countries must make.

It's hard to see how those payments will be reduced without the involvement of the U.S. Government. Reducing interest rates and forcing banks to accept smaller margins are two ways; encouraging long-term capitalization of interest is a third; and a variety of schemes for international refinancing at lower rates are afloat. Suggestions such as that of Brazilian presidential candidate Tancredo Neves, who has advocated that no more than 20 per cent of his country's export earnings be used for debt service, should be taken seriously. To say that such changes are private concerns between borrowers and lenders ignores the reality that the American worker has a very large stake in the outcome. WV