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John Bellamy Foster

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The Financial Globalization of Brazil under Lula

by Daniela Magalhães Prates & Leda Maria Paulani

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François Chesnais has defined three stages in the process of financial globalization. The first took place in the 1970s and he calls it “indirect financial internationalization of closed national systems.” Latin American countries including Brazil took part in this process of attracting a substantial volume of loans. The second stage, 1980–85, started with Paul Volcker’s “dictatorship of creditors” and the discovery by Margaret Thatcher of neoliberalism as the doctrine for the new age. The center countries, starting with the United States and Great Britain, unlocked their financial markets by liberalizing the international flow of capital. The interlinking of national systems became more direct and immediate through market finances. In Latin America, the debt crisis exploded with rising interest rates (following the negative Volcker shock) involving massive debt contracted in the prior period brokered by the banking system.¹

According to Chesnais the last stage commenced in 1986 with the accelerated interlinking of national systems by financial markets through the incorporation of peripheral countries. The opening and deregulation of stock and bond markets of the so-called Newly Industrializing Countries and of the third world in general started in the 1990s. Measures taken by the Collor/Itamar and Cardoso governments were instrumental in preparing the Brazilian economy to participate fully in the financial turn of the capitalist economy. The Luiz Inácio Lula de Silva (Lula) Administration perpetuated this process.

The nature of the international presence of our economy as articulated by the current administration has proved that, if there has been a “specialization” of Brazil in the past fifteen years, it was the capacity to offer fantastic profits to international financial capital, a skill acquired gradually. In

short, it has not been trade that has increasingly inserted Brazil in the world economy but finance. The efforts of the Lula government have concentrated on consolidating the country's position as a provider of cheap assets and as an international platform for financial valorization. This trend becomes clear if we follow the evolution of interest payments in the foreign payments balance sheet: from less than \$12 billion in 1990, to \$21 billion in 2002 (Cardoso's last year in office) and \$29 billion in 2005, perhaps reaching \$35 billion in 2006. The evolution of portfolio investments (the paradigmatic investment in this latest stage of financial globalization) has been even clearer: from almost \$400 million in 1990 to \$9.8 billion in 2002 and \$12.5 billion in 2005. In light of measures adopted early in 2006 to provide incentives for sales of Brazilian bonds among non-residents, the expense will easily pass the \$15 billion mark this year.

Contrary to governmental propaganda, the net result of this kind of increased international economic "presence" has been to make the country more not less vulnerable. The present positive evolution of voluntary capital movements has not been the result of the "positive foreign shock" alone. There has also been an internal factor in play, the kind of monetary and currency policy articulated during Cardoso's last period and continued *in toto* by Lula. The problem with that kind of policy has been that it has created a new circle in which the consequences of decisions by investors generate their own continuity. The deluge of dollars that penetrated the Brazilian economy through portfolio investments has not come after high interest rates alone, but also after the appreciation of the domestic currency, which further raises potential profits in hard international currency. The growing entry of foreign currency has guaranteed that the Brazilian real will continue to appreciate, and that this will bring ever larger amounts of hard currency in, representing a kind of speculative bubble centered on the real. In short, expectations generate decisions that create the expected results—for the time being. The markets in derivatives have further reinforced this circular, seemingly self-perpetuating motion. Considering the instability of the factors fueling this process (the abundant liquidity of international markets), it is obvious that when the process has reversed the same mechanism that now magnifies "the good results" will magnify the eventual disaster—no matter how good the external vulnerability indicators might seem to be.

Lula and his Workers' Party (PT) have been the harshest critics of Cardoso's policy of concession to financial interests. However, once in power, Lula did not take the necessary steps to get the country out of the trap. On the contrary, he has followed with enthusiasm the road already taken, not only following an ultraconservative

macroeconomic policy, but intensifying the financial opening of the economy. He has benefited from a sort of “positive external shock.” But when the wind turns (it started veering in 2006) his irresponsibility will be clear, and the house of cards on which the phony and lukewarm growth of the country under his administration was erected will be apparent to all.

The Evolution of Brazil’s Balance of Payments

The unfavorable international situation, resulting from the global financial crisis of 1997–99 (usually referred to as the “Asian Financial Crisis” but also extending to Latin America, and in particular Mexico, Brazil, and Argentina) enormously complicated Fernando Henrique Cardoso’s second term (1999–2002). The winds changed for the better both in international trade and finance in 2003–05, the first three years of the Lula administration. Bearing in mind the continuity in economic policy vis-à-vis the former government, our hypothesis is that the benign international situation, not internal economic policy, was the fundamental factor in the seemingly improved Brazilian external situation in the Lula period. It is from this standpoint that common assumptions regarding Brazil’s reduced external vulnerability have to be questioned.

The position of Brazil’s economy within international markets has undoubtedly undergone important changes in the first three years of the Lula administration. This can be gauged by following the evolution of the two main items in the payments balance sheet of the period: the current account balance and the capital and financial account balance. The net result of current account transactions showed a growing surplus (the first since 1992) during these three years of \$4.2 billion in 2003, \$11.7 billion in 2004, and \$14.2 billion in 2005 based on growing trade surpluses obtained since 2001 (rising from \$13.1 billion in 2001 to \$44.8 billion in 2005).

At the same time as a surplus grew in the current account, the capital and financial account went into deficit in 2004 and 2005, reflecting the fact that Brazil was reducing its external financial liabilities. Nevertheless, this deficit in the capital and financial account balance, which might at first glance suggest that Brazil is moving from a debtor to a creditor position in the world economy, must be looked on with extreme caution because it masks the behavior of capital dominated by two different dynamics: voluntary capital (non-IMF regulated capital movements) and operations regulated by the IMF. The favorable international conditions alleviated external restrictions and made possible the payment of all debts to the IMF in 2004–05. In 2005 capital and financial accounts were negative by more than \$9 billion. However,

the voluntary capital balance showed a surplus of \$13.8 billion based on foreign direct investment as well as portfolio investments—a reality that was disguised in the overall capital and financial account balance by the early payments to the IMF (registered under “regulated operations”).

This performance of the two primary accounts (the current account and the capital and financial account) in the balance of payments—reflecting the evolution of the international presence during this period—is associated with “legacies” from the Cardoso government, such as the floating exchange rate adopted after the exchange crisis of 1998–99, the devaluations in 2001 and 2002, and the intensifying of the financial opening. Those changes are closely related to a benign international situation of those years on the trade and the financial fronts.² But they also reflect the financial globalization of the Brazilian economy in ways that point to continuing structures of external vulnerability. The Brazilian economy remains highly vulnerable to volatile movements in financial capital.

Financial Liberalization

The financial presence during the Lula administration has been conditioned by three main factors: a widening financial opening, a new cycle of liquidity in the international markets for periphery countries, and a floating rate of exchange. Brazil’s financial opening had cautious beginnings in the late 1980s, during the Sarney administration, but was decisively intensified in the Collor/Itamar and Cardoso administrations. The Lula administration gave continuity to that process using the same ad hoc approach as its predecessors, through resolutions and Central Bank decisions, and by issuing decrees on financial liberalization. Natural and legal persons (corporations) were permitted for the first time to buy unlimited foreign currency directly from banks (this type of operation was formerly regulated by the Central Bank) to be invested abroad. In the event of the sale or cessation of foreign investments, it was no longer mandatory to return the monies made to the country, and these could be freely reinvested abroad. Also from then on any individual could send money abroad without having to operate through an old expedient—the so-called CC5 accounts—which made these remittances more expensive. Capital outflows became not only simpler, but cheaper. The net result of these changes was that it was much simpler to convert reals to dollars and send them abroad. At the same time, the Lula administration extended the time exporters could keep their hard currency abroad and, more recently (May 2006), announced it is studying the possibility of allowing exporters to keep abroad the currency earned by exports and needed to buy imports.³ Lastly, as of February 2006, fiscal incentives were provided

to foreign investors to buy domestic debt bonds by lowering taxes. The measure also permits initial public offerings and capital openings by private companies. The abundant international liquidity and the intensification of financial opening in Brazil combined to produce a substantial inflow of \$13.8 billion in voluntary capital in 2005.

Despite a rise in dollar values, the Brazilian stock exchange has remained the cheapest among emerging countries. That and the expectation of a continuing revaluation of the real have attracted foreign investments with the promise of large profits in hard currency. Under these circumstances it is rational to raise warnings about the nature of this kind of circular flow, repeated with other kinds of financial assets. The self-feeding frenzy that this entails is a normal feature of any upswing in financial speculation. But such a virtuous circle is almost certain to become a vicious circle on the downswing.

These and other changes altered the composition of and enlarged the foreign liabilities of the Brazilian economy. With the growth of direct foreign investment, and mainly with the growth in portfolio investment, the stocks of productive and financial assets owned by non-residents were enlarged, while the foreign sovereign debt lost relative weight. The continual revaluation of the real and the very high rate of interest were critical to that outcome, particularly after the acute devaluation of late 2002.

The Trade Presence

The period 2003–05 was, as we have seen, one of growing trade surpluses, producing positive results in current transactions. Since the period was also characterized by a continuing process of revaluation of the real, it could be asked how and why trade surpluses went from \$13.1 billion in 2002, to \$24.8 billion in 2003, \$33.7 billion in 2004, and \$44.8 billion in 2005. A study by UNCTAD shows that the terms of exchange do not explain the evolution, since they grew by just 3 percent between 2002 and 2004.⁴ The explanation is the expansion of international trade led by the United States and China, the two giants, and the rise in the price of natural resources, crucial to Brazil's export position, which constituted a "positive foreign shock" in the trade sphere (a shock that also affects, as we have seen, the financial sphere). In fact, the recovery of the Brazilian foreign trade sector had started in 1999, after the Cardoso deficit years. The changes in currency policy after the crisis that abruptly collapsed the real early in 1999 led to an increase in exports particularly in basic and semi-manufactured products in 1999–2002.

Yet, good global results notwithstanding, Brazilian exports have remained technologically backward and, therefore, not dynamic in terms of world trade. Brazil's exports are fueled by the agrarian sector, the mineral industry, steel, and by those sectors in which Brazil is competitive because of low wages and abundant natural resources.⁵ The continuing importance of commodities in the portfolio of exports is an indication of its fragility, as commodities—the main engine of the Brazilian exporting performance—were the least important factor in the export performance of developing countries such as India, Mexico, and China.

Brazilian imports have remained concentrated on mid- and high-technology products. The share of these sectors in foreign purchases has remained stable at 60 percent between 2002 and 2005. These sectors (electronics, electrical materials, chemicals, and pharmaceuticals) have been dominated by transnational companies and there has been no substitution of imports after the devaluations. Such substitutions would have required state coordination of industry, science, technology, and foreign trade policy.

The general conclusion therefore has to be that the pattern governing the foreign trade position of Brazil's economy has not changed during Lula's government. That pattern was consolidated in the 1990s through the opening of trade, the revaluation of the domestic currency in real terms, and new strategies by transnationals (in Brazil's case, local branches acting more as purchasers for the domestic market than producers for the global market). That process has resulted in a regressive specialization of Brazil's industry, a loss of important capital and technology intensive sectors, and simultaneously a diversification and growth of traditional sectors, based on natural resources and labor.

The 2003 UNCTAD report has classified developing countries in four groups: *mature industrial countries*, such as Korea and Taiwan, where industrial growth has slowed down because they have reached a high level of industrialization; *rapidly industrializing countries*, such as China and India, showing high rates of domestic investment because of their industrial policy and export incentives; *countries with industrial outposts*, such as Mexico, which shows growth in industrial exports but falls short in investments, value addition, and total productivity; and *de-industrializing countries*, economies with a declining share of industry output in their GDP. Brazil is squarely in the last group and the Lula government's complacency with the situation and its results in foreign trade indicate that the country will soon have to leave behind even such an unflattering label. In fact, a dialectic of de-industrialization and financial globalization constitutes the recent economic experience of Brazil under

Lula, who has, unfortunately, continued the same basic policies as his predecessors. When the wind finally turns, as it must, the dire consequences of this irresponsible policy will become all too apparent.

Notes

1. Introduction to F. Chesnais, ed., *A Mundialização Financeira* (São Paulo: Xamã, 1998).
2. Analysis of the financial presence precedes that of the trade presence because the level of financial opening and decisions of investment by foreign portfolio managers exercise a decisive influence on the behavior of real and nominal exchange rates, crucial factors for the country's trade presence.
3. The government's alibi for that measure is that there is a glut of dollars in the domestic market, which could lead to a revaluation of the real. However, that kind of measure makes the country much more vulnerable externally in the case of a change in direction of the gentle winds still blowing in the international financial markets (nobody knows for sure for how long). Meanwhile, the Senate will debate a law to do away with any obligation, thus opening the way for the ultimate financial opening, that is, the possibility of keeping the profits of exports in dollar-denominated accounts in the domestic bank system. That would mean that the inflow of hard currency created by exports would be subordinated to the same variables governing financial flows: differentials between domestic and international interest rates, expectations of change in exchange rates, and risk of default. Thus, the space of maneuver would be reduced and the Central Bank would have trouble stocking up foreign reserves.
4. UNCTAD, *Trade & Development Report* (Geneva, United Nations Conference on Trade & Development, September 2005), chap. 3.
5. The methodology adds up products from the *Standard International Trade Classification* (SITC).

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