

External Debt Nationalization a Major Tendency on Brazilian External Debt in the Twentieth Century: The Shifting Character of the State During Debt Crisis.

By

Luiz M. Niemeyer, Ph.D.
Catholic University of Sao Paulo-PUC-SP
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Abstract

This paper discuss the shifting character of the Brazilian State in several major debt crises through out this century including its more recent one in that starts in 1999 and is considered to end in 2005 when Brazil paid in advance its debt with IMF. The intention here is to review the role of the Brazilian State during these debt crises. It is showed that pressures from the international capital market and the country's private sector forced the Brazilian State to assume the debt risk and obligations of the private sector. This process is called "the nationalization of the debt" of the Brazilian external debt. Our major purpose is to see whether the recent debt process (1994-1998) and its repercussion until 2005 shows the same trend as the 1976-1982 period - that is, to see whether the State ended up bailing out the risks of the huge amount of portfolio investment that the country received. The tendency for external debt "nationalization" is present in the recent external debt of Brazil (1992-1998). But, contrary to the debt cycle of 1967-1982, the external debt "nationalization" of the 1990's, follows the pattern similar to the external debt cycle of 1947-1962.

1. Objective

The objective of this paper is to analyze the role of the State in the process of the external debt of Brazil. Specifically, our thesis is to find out if historically, the State assumed all the risk by "nationalizing foreign obligations"--in which economic losses are socialized while economic gains are privatized--as was the case in the 1982 debt crisis (Cruz 1984).

Using the historical method, this paper will help us to understand the shifting character of the Brazilian State during the recent process of external borrowing by the country (1994-1999) and its repercussion until 2005 when the country paid in advance its loan with IMF.

We will see whether the recent debt process (1993-1998) shows the same trend as the 1976-1982 period -- that is, to see whether the State will end up bailing out the risks of the huge amount of portfolio investment that the country received. We are considering the analysis of the 1982 debt crisis as a benchmark because since this crisis the Brazilian economy interrupted the outstanding growth path that the country had from the 1930s to the early 1982.

The idea of "socialization of losses" in the Brazilian economy dated back at least to the beginning of this century when the coffee valorization scheme reached its apex. Furtado (1963) well described how the coffee producers succeeded in transferring to the whole society the burdens of the ups and downs of the coffee trade cycle by keeping the exchange rate below the par.

Since Brazil in this century can be considered one of the leading borrowing countries, his experience gives grounds to the understanding of the role of State on external debt crisis in major developing economies.

In order to search for historic trends about the behavior of the Brazilian State on external debt crisis we will analyze and compare different and critical periods in recent Brazilian economic history in which the external debt played a significant role in the economic life of the country. It is relevant to mention a methodological aspect that will be taken into consideration.

With the exception of the current period that is still underway, the periods chosen ended up in debt crisis. Therefore, in the topic that we are approaching (that is, the role of

the state), it's very difficult to identify if they are related to the causes or the consequence of the debt crisis.

In order to approach this relevant point in each historical period under analysis, we will start with a subperiod of relative stability and then we will move to a subperiod that ended in debt crisis. That is, each historical period under analysis will consist of two periods, one "stable"¹ and other one that resulted in a debt crisis. The periods to be compared, which will each represent a section of the paper, are 1906-1930; 1947-1962; 1967-1982; 1992-1998. In the last section we present our conclusions.

Nationalization of external debt in historical subperiods

| Period | 1906-1932 | | 1947-1962 | | 1967-1982 | | 1993... |
|-------------------|------------------|------------------|------------------|------------------|------------------|------------------|----------------|
| Subperiod | Stable | Unstable | Stable | Unstable | Stable | Unstable | N/A |
| Years | 1906-1914 | 1920-1931 | 1947-1955 | 1956-1962 | 1968-1974 | 1975-1982 | 1994... |
| Bailed out | NO | Yes | YES | Yes | No | Yes | Yes |

2. The Old Republic 1906-1930.

In the period under study the Brazilian State was the principal external debtor. As observed by Topik (1987), international capitalists have frequently encouraged state presence in the economy to assure a safe investment climate. The Brazilian state borrowed heavily to finance its budget deficit, infrastructural investments, railroads and the coffee valorization scheme. The state's role in the foreign debt was powerfully affected by the Taubate Convention of 1906 and its policy of coffee valorization, since the basic funding of the Convention was external debt.

Suzigan and Villela (1973:332), report that during the period from 1890 to 1931, Brazil received new loans amounting to £ 343,4 million, paid £ 365,4 million and increased its external debt by £ 245,9 millions². This discrepancy stopped between 1932

¹ In Latin America economies it is very difficult to find 5-years period of stability. That is why we are using the term "relative stability".

² For Oliveira (1977:16), the coffee production, responsible for an important share of the external debt, was a kind of production that consumed itself in its own financing.

and 1945. Until 1934, 75 percent of the trade surplus was used in the payment of the external debt while this percentage dropped to 40 percent between 1934 and 1945.

The 1906-1914 period was a rare time of economic stability in Brazilian history. Inflation was not a relevant issue and did not affect the outflow of capital. In strong contrast, the Brazilian economy in the 1920s faced high instability coupled with inflation.

In order to check if the state ended bailing out the debts of the private sector we will concentrate our analysis on the international finance of the coffee valorization. At the beginning, the operation was managed by the Sao Paulo State together with the major international coffee importers, who provided two thirds of the resource needed.

Exports accounted for between one third and one-fifth of GDP during the Old Republic. Coffee and rubber³, often responsible for over 80 percent of the country's exports, propelled the economy. Sao Paulo was by far the major coffee producer responsible for around 80 percent of the coffee crop..

The Old Republic a decentralized republic suited the interests of powerful export oriented groups, and the ancient patron-client system found its political expression in the *politica dos governadores* by 1900. Sao Paulo State more than the rest, chose the route of foreign borrowing (Love 1980).

In the period under study Sao Paulo State was the major player on the valorization of the coffee hence we will concentrate on the behavior of this state:

External financing of coffee valorization and the extensive penetration of Sao Paulo by foreign capital led to a degree of foreign political control, at least to the extent of restricting Sao Paulo's political options. Love (1973: 251)

2.1. Brazil- 1906- 1914- Federal Government Indirect Participation

Marischal (1987:171) reports that by 1914 Latin American government debt reached more than US\$ 2 billion. Fifty percent of this amount was contracted during the previous century. The other half was contracted in the loan boom of 1904-14. During the World War I period, Latin America, which has been a net capital importer since the middle of the XIX century, became for some years a net capital exporter using part of its trade surplus to repatriate some of the debt.

³ The rubber production faced a crisis in 1910 due to the competition that never recovered.

The quasi-gold standard, established in Brazil in 1906 through the creation of the Conversion Office (TCO) which financed and supported the coffee industry, eased the way for capital flows into the country. Hence the maintenance of a relevant level of gold reserves worked as a window dressing to attract large flows of capital. When the Bank of England raised its interest rate, its immediate effect was on short-term capital movements and then on international gold. Brazil became short of commercial finance since this type of capital flowed to UK, and Brazil had to use its gold reserves in order to honor its international obligations. Additionally Lewis (1938: 149) adds that-“ accumulation of short-term capital in a country was paralleled by a large inflow of gold, and presumably their exit from the country will be marked by an outflow of the metal". Together with these inflows we have the presence of the abnormal short-term capital and the consequent capital flight associated with it. Hence, gold convertibility made possible a huge capital outflow (Furtado 1963:229).

In the first subperiod, we do not see the state bailing out the debt of the private sector or the debt of Sao Paulo state, which acting throughout this period in the interest of the private sector. Hence, the socialization of the losses can be found in the work of the TCO (Treasury Conversion Office) through its exchange rate policy rather than through the nationalization of the foreign debt.

The complicated valorization scheme to defend the coffee economy worked relatively well until the 1930's (Furtado: 1963: 224). Furtado points out that the coffee producers succeeded in transferring to the whole society the burdens of the ups and downs of the coffee trade cycle. He characterized this transferring as “the socialization of losses”. By keeping the exchange rate below par, the rest of the society subsidized exporters. For instance, when the coffee prices declined in the international markets, the exporter's milreis earnings fell less because of currency's devaluation; on the other hand, coffee producer's costs rose more slowly.

As observed by Delfim Netto (1979: 67) the first coffee valorization inaugurated in 1906 inspired in the Taubate Convention of the same year was a *market corner* promoted by private capital operating in the behalf of the government. For Love (1980), valorization was essentially simple; a foreign loan would be obtained to purchase coffee from planters and stockpile it; in year of bad harvests this supply would be released on

the international market; and meanwhile all exported coffee would be taxed at a high enough rate to repay the foreign loan. In theory, coffee debts were self-liquidating through the gold surtax.

Due to Federal Government resistance, Sao Paulo State took the lead and together with the major coffee importer Hermann Sielken, promoted the first valorization. The “Sielken syndicate” worked as follows: the major coffee importers from the USA and Europe provided 80 percent of the required funding to buy the coffee and the remaining 20 percent was to be provided by Sao Paulo State, who in turn borrowed it from international banks.

As Delfim Netto (1979:50) reports in August 1908, Sao Paulo State borrowed £ 1 million from the Bank fur Deutschland; in December of this year a £ 2 million loan was negotiated with the Schoroder & Co. of London and a £1 million loan from National City Bank of New York; both loans carried a four year term with a grace period up to 1908. By June 1907 the Sao Paulo State had bought and stockpiled 8 million sacks.

By the end of 1908, Delfim Netto reported the following liability position related to the stockpiling of 7 million sacs of coffee: a) a £ 2 230 thousand debt to Schoroeder City Bank; b) and a £ 10 457 thousand related to advances provided by the importers. In order to consolidate this debt a £ 15 million “funding” loan was floated in December by the Sao Paulo State to roll over the valorization debt.

According to Fausto (1985: 222), the Sao Paulo State loan was floated with a group of Banks such as Schoroder & Co, Banque de Paris et Pays Bas and Societe General de Paris. Bearing in mind that the first Brazilian funding loan of 1898 amounted to £ 10 million pounds this huge 10 year loan was floated thanks to the guarantee of the Brazilian Federal Government under Afonso Pena. It is also relevant to mention that under the loan agreement the Sao Paulo State also provided as a guarantee 7 million of coffee sacs that was stockpiled.

Another cost of the valorization was the lost of control of coffee marketing to foreign lenders after 1908. In a sense, valorization was a strong response to foreign control. However, financing arrangements instead gave exporters and foreign financiers even greater control. (Love 1980: 49). The sale of the coffee given in guarantee was controlled by a committee of seven members. Four members were designated by

Schoroder & Co that became the manager of the valorization. Two members were nominated by Societe General de Paris. The remaining member was appointed by the Sao Paulo State.

In June of 1913 the £ 15 million loan was paid in advance and the coffee valorization defenders throughout the Old Republic will use this payment as “ a real proof” of the viability of the coffee valorization scheme. In my opinion the payment in advance was more evidence of an attempt to get rid of the foreign control over coffee exports than of any strong economic viability of the program. My reasoning is based on the fact, previously reported, that in 1922 the federal government floated a £ 9 million 10-year loan carrying a proviso that Brazil should avoid a new coffee valorization plan. This loan was paid in advance in 1923 to fight this proviso.

With the beginning of the World-War I in July of 1914, the flow of capital stopped. Brazil was facing a 30 percent increase in imports, and 80 percent increase in amortization (Brazil started to repay the 1890 funding loan in 1911).Technically, Brazil did not default on its external obligations, but in August, due to a massive run, the TCO closed and the foreign exchange market collapsed. The country had to sign the second “funding loan” (a "debt renegotiation" loan; the first one was signed in 1898) of £ 14502 thousand in 1914 which was disbursed in 1915.

2.2. Federal Government Direct Participation and Sao Paulo's Response (1920-1931)

Eichengreen(1990:239) reports that the gold standard of the inter-war period was a hybrid, neither a pure gold standard like that which prevailed in neither various countries prior to World War I nor a fiat money system like that which succeeded the breakdown of Bretton Woods. With the gold standard of 1925-1931, London was subject to new and powerful competition from New York and, on a minor scale Amsterdam.

For Jorgensen and Sachs (1989:52), however, the overall level of international capital flows never recovered to that of its heyday in the period 1870 to 1914; flows of real private investment between 1914 and 1930 were only two-thirds as great as those

between 1900 and 1913⁴. Furthermore, during the inter-war period, developmental finance for the periphery was eclipsed by lending, for reconstruction and servicing the war debt, between the industrialized countries. Latin American countries date the start of the Depression from the second half of 1928 due to the abrupt halt in foreign lending in June 1928 when the New York stock market started its meteoric rise and interest rates tightened on the call money market (Klinderberger: 1984: 317). When comparing the debt crisis of the 1930s with the ones from the previous century, Eichengreen (1991: 151) stressed as the major difference the universal character of the former. The majority of sovereign debtors suspended interest payments and initiated protracted negotiations. The 1929 depression marks the beginning of a period of about 15 years during which hardly any foreign capital flowed into Latin America.

1920-1923

In the beginning of 1921, encouraged by the success of the two previous valorizations⁵, the Federal government, under the presidency of Epitacio Pessoa, promoted the third coffee valorization scheme, the first one under his control. As reported by Delfim Netto (1979: 78) the prompt participation of the Federal government was due to financial difficulties of the Brazilian state and the profitability associated with the operation, and the need to solve the alleged national problem of the coffee industry.

In 1921, the central government created the "provisional' Rediscount Department at the Bank of Brazil (BB). The storage of 4.5 million of coffee sacks⁶ was financed with money issuance. Part of this issuance was backed by a £ 5.5 million short-term loan.

In the beginning of 1922, the Brazilian government was unable to repay this short-term debt. Using as a guarantee the 4.5 million coffee sacs previously acquired the Federal Government, in May, floated a 10-year, £ 10 million loan. Delfim Netto (1979: 78) reports that, as in the first valorization, a committee of bankers was created. The members of this committee were designated by Rothschild, Schroeder, the federal

⁴ James (1992: 596), reports that in 1911-13, the average annual capital export of Britain, German, France and the U.S. to the rest of the world was \$1400 million. In the period 1924-28, when capital flows were at their greatest, the annual figure was \$860 million (or \$550 million in prewar prices).

⁵ The second valorization program, funded with federal government credit, was adopted during World War I and lasted from 1917 to 1920.

⁶ One sack of coffee equals 60 kilograms or 132 pounds.

government and the Brazilian Warrant, an international trading company that dominated coffee markets, fiscal and future. The loan carried the proviso that Brazil should avoid a new valorization plan. It also ruled that the Federal Government could defend the coffee through the Brazilian Warrant only.

1924-1929- *Sao Paulo Takes Control*

In early 1924 the federal government paid in advance the £ 9 million loan to combat the strict covenants. Additionally, Delfim Netto (1979: 88) reports that the coffee planters, unhappy with the previous strict control in the industry, pressed the Federal government, which then transferred the control of the valorization to Sao Paulo State.

In January of 1926, as previously reported, the Instituto Paulista de Defesa Permanente do Café (IPDC) made a £ 10 million short-term loan from Lazard Brothers. In the second semester of this year the recently organized Sao Paulo State Bank was granted a £ 5 million per year credit line. At the Federal level, in 1926, the Stabilization Office (SO) was established to provide stable, cheap milreis to the coffee exporters. In 1927 the amortization of the 1914 funding loan began and the Washington Luiz had to balance the requirements of the Paulistas and the Treasury.

At the outset of the Depression, the coffee sector enjoyed an "automatic" benefit when capital flight and the end of gold convertibility for the milreis produced a devaluation of the currency; part of the coffee sector's losses could thereby be transferred to the population at large through rises in the prices of imports, while planter receipts milreis rose (Furtado 1963).

1930-1931

In early 1930, there was increasing tension between the powerful coffee planters. President Washington Luis' first response to the crisis was to protect the milreis rather than planters. Fausto (1985:248) reports that the tension reached its peak during the coffee planter's conference in the end of December of 1929 and early January of 1930. Several requests were presented to the president among them one the £ 10 million held by the Banco do Brasil be used to finance the coffee producers.

As reported by Love (1980:59), due to the prompt refusal of this request by the Federal government, Sao Paulo State, before the fall of Washington Luiz (Brazilian President from 1927 to 1930), floated a 10 year, £ 20 million British Valorization Loan with its collateral stock supervised by foreign banks who established the amount of coffee to be remitted.

By 1930, Topik (1987: 27) reports that the Brazilian currency the milreis, lost about 80 percent of its value. The revolution lead by Getulio Vargas in October of 1930- interpreted as a reaction against an economic system defended by Paulista politicians- marks the end of the Old Republic. In December of 1931 Sao Paulo's IPDC turned over its responsibilities to a newly created federal government organization and the coffee industry returned to the federal government supervision. The Vargas provisional government abandoned the exchange rate system and a new exchange control was introduced in March 1932. By December of 1932 most state and federal loans had gone into default.

The Sao Paulo £ 20 million British Valorization Loan was turned over to the central government. "Consequently, the Paulistas got off at less than the full cost of the capital they borrowed for valorization" (Love 1973: 248). If one accepts the view that throughout this period Sao Paulo State was a representative of the private sector (since the coffee valorization program served mainly the interest of the private sector), we can say that, contrary to the period of 1906-1914, in the 1920-1931 period we have the "nationalization of foreign obligations" when a debt crisis occurred as was the case in the 1932 debt crisis.

A federal decree of March 2, 1932 divided Brazil's loans into seven grades. The more famous "Aranha Plan" of February 5, 1934, added one more category, but basically kept to the same scheme of establishing priorities for payment of interest and the repayment of principal. In both plans, the first grade was reserved for Brazil's three federal Funding Loans (1898, 1914 and 1931), and the second exclusively for the Sao Paulo coffee Realization loan. The first grade called for loan repayments and full interest as scheduled; in the case of SP loan, only interest was to be paid on schedule, but the repayment of the principal was to be stretched out. In the 1932 plan, no state loans other than those of Sao Paulo were assigned a priority higher than grade four...In the 1934 scheme, Sao Paulo was the only state to have loans in the first five grades (of which only the first two repaid any principal...(Love 1980:251).

3. The Years of Rapid Economic Growth (1947-1962).

Because of the sharp increase in external capital inflows during the 1950's, Brazil's total capacity to import grew at a substantial rate. This enabled the country to sustain high rates of economic growth—following an Import Substitution (ISI) path--until the early 1960's. Throughout the 1950's the terms on which Brazil obtained sufficient external financing for its foreign exchange (FE) gaps progressively deteriorated and the country had to face an upward trend of effective interest rates combined with a downward trend in the maturities-structure of outstanding indebtedness. Beginning in 1960, the economy was plagued by a severe cash-squeeze liquidity crisis and the country was forced to negotiate with the IMF (Donnelly 1970: 137).

Andrew Gunder Frank (Bandeira 1978: 91) reports that during the period from 1947 and 1960, Brazil received new loans and FDI amounting to US\$ 1814 million, paid US\$ 2459 million as a service for the debt and FDI. Gunder Frank also reports that to this negative net balance of US\$ 645 million between inflows and outflows of capital we should add US\$ 1022 million related to clandestine capital flights.

The accumulation of commercial arrears and their subsequent renegotiations proved unsatisfactory to both creditor and debtor countries. ... This situation hastened the transition to organized financing systems for medium-term suppliers' credits (credits of between one and five years), since central banks became increasingly unwilling to continue financing the accumulation of commercial arrears.... In this way, a number of governments sought to transfer gradually an increasing share of the responsibility for the provision of export financing to the supplier, or rather, in view of the latter's nominal reliance on bank credit, to the private banks. (United Nations 1967: xi).

In the period under study our analysis will be centered on the debt rescheduling of payments of commercial arrears and suppliers' credits. According to IBRD (1967: 21) the rescheduling operations during this period often had been confined to this type of credits alone and were conducted by informal debt rescheduling clubs constituted by the principal creditor countries involved, e.g., the "Paris Club" and the Hague Club. The idea behind these clubs was to share equally among its members the burden of refinancing and also to adopt a uniform position in relation to the debtor country. Brazil had to face this kind of negotiation in 1953, 1961 and 1964.

3.1. The Second Vargas Government and the Commercial Arrears (1947-1955)

It is the time of “the world dollar shortage” and private capital exports from developed countries achieved from 1947 to 1954 only 50 percent of the 1920’s volume. Developing countries were very dependent on official loans and grants. Due to developing countries' developmental effort and the related import burst, it's a time of lower priority on reserve accumulation.

We are considering the period under study stable in the sense that the economy kept its path of growth despite the inflation peak of 25.6 percent in 1954. Politically, however, the final two years were extremely unstable, chiefly in mid-1954 when Vargas was overthrown and committed suicide in August.

Getulio Vargas (1951-54) was elected in October 1950. He had made clear during his election and in the beginning of his term that his government would not be liberal to the international capital as was his predecessor Eurico Dutra’s (Malan 1985: 72). In January of 1952, the Vargas Government decided to impose restrictions on profit remittances. This severely affected the relations of the US⁷ and Brazil.

In the end of 1952, as previously reported, Brazil amassed US\$ 541 million commercial arrears with U.S. exporters and European exporters being its principal creditor. On the external front, Vargas had to face an interruption of external financing. Skidmore (1967: 117) remembers that in 1953, the Joint United States- Brazilian Economic Commission was terminated since the Truman Government⁸ was replaced by the Eisenhower administration. The new administration was “openly suspicious of the need for any special measures to aid in the economic development of the poorer nations”.

Additionally Vianna (1987: 17) reports about the intention of the World Bank to influence more deeply the economic policy of the borrowing countries. The foreign

⁷ As a background Vianna (1987: 67) informs us that between 1949 and 1954, the net investment in manufacturing by the USA in Brazil represented 53% of the USA's manufacturing investment in Latin America and 17 percent of its world wide investments in this sector (34 percent if Canada is not included). Therefore in response to several pressures that were created, the “free foreign exchange “market was included in the Res.70 of Sumoc of February 1953. The Vargas Administration established a “free”cruzerio market, which could be used for the unlimited remissions of profits by foreign investors.

⁸ Through its Point Four Program the Truman Government was sympathetic to the financial problems of developing countries. The technical studies by the Joint Commission were developed from July 1951 to July 1953.

exchange crisis of the end of 1952 furnished the ammunition for the argument of the World Bank.

During the negotiations of the US\$ 300 million loan from the Eximbank to pay the US exporters arrears, Vianna raised an important point. The author (Vianna 1987: 87) stressed the conflict between the Eximbank and World Bank. While the first one was susceptible to the lobby of American exporters the second was more sensitive to the claims of the New York banking community. While the U.S. government was pro-World Bank, the Congress was pro-Eximbank.

During the exchange crisis at the end of 1952, the World Bank wanted to intervene in the Brazilian economy and was against the US\$ 300 million loan from the Eximbank. The Eximbank was acting in the interests of the U.S. exporters and was not in favor of the intervention proposed by the World Bank. In the end, the American exporters succeeded in lobbying the US Congress and in April of 1953 the loan was approved despite the resistance of the US Government. Due to World Bank pressure, the loan carried hard conditions for Brazil.

The US\$ 541 million commercial arrears of 1952 was related in its major part to the acquisition of capital goods and the necessary equipment needed to maintain the industrialization drive⁹. In the case of USA, commercial arrears were covered through US\$ 300 million loan from Eximbank. In the case of England, a loan was made with the Bank of London in 1953 in the amount of US\$ 158 million. The negotiations involving the refinancing of these arrears are very important for the subject matter of our dissertation.

As reported by Sprott (1965: 83) many of these commercial arrears were related to orders from the private sector, which anticipated that adequate exchange would be available in the exchange auctions. As reported previously in the exchange rate system of 1948-1953 import licenses meant big profits. Licenses were granted on the basis of estimated quantities of exchanges likely to be available in US dollars.

Since the exchange was not available, this short-term private debt, due to the negotiations that followed, magically turned on the largely increased public medium and

⁹ According to Bresser Pereira (1984: 23), the Brazilian exchange system between 1947 and 1953 was transformed into a powerful stimulus to industrialization.

long-term debt that jumped from US\$ 638 million in 1952 to US\$ 1159 million¹⁰ in 1953. That is, the Brazilian State ended bailing out the risk of the private sector.

The commerce and industry association of New York protested to the Brazilian Ambassador that American business confidence was being jeopardized by the slowness to bail out exporters-exporters, it should be remembered whose bad judgement of a financial situation alone accounted for their difficulties, a mistake in judgement for which presumably the Brazilian government was not to blame
(Hansen 1953: 28).

3.2. Planned Import Substitution (1956-1962)

The dollar shortage debate associated with the Triffin dilemma dominated discussion in the 1950s and early 1960s . After 1955, together with balance of payments loans, suppliers' credit became a major source of financing for developing countries. According to Guth, a decisive factor for the large share of supplier's credit was that exporters were able, in the majority of industrial countries, "either to use credit facilities of government-subsidized institutions or at least to offset their own risk by relying to a considerable extent on government guarantees"(Guth 1963: 35). The large share of this type of financing in developing countries gave rise to concern since the usual term of these loans is 5 years. Guth also observed that long-term private loan finance to developing countries had almost disappeared during this period.

The high rate of growth and the high instability that characterized the 1956-1962 years was reflected in the increasing rate of inflation. The Kubitschek government (1956-1960) relied strongly on supplier's credit to finance the imports of the Target Plan. Donnelly (1970: 141) reports that in 1960, suppliers' credit¹¹ represented 38 percent of the total external debt (Group I and II) or 58 percent of private resources accounted as project credits.

On March 15, 1961 the new government of President Quadros promotion of a devaluation of 100 percent occurred (Skidmore: 389). In April of 1961, this government

¹⁰ In most instances, importers who had received import licenses were able to pay the cruzeiro counterpart to the Banco do Brasil. But owing to the insufficiency of foreign exchange, the Banco do Brasil was unable to pay foreign exporters when presented with import documents for collection. The subsequent accumulation of commercial arrears, which, in effect, constitute loan "forced " from foreign exporters took the form of official short-term debt (Group IV) since they represented the official responsibility of the BB (Donnelly 1970:99).

¹¹ 9 percent of all suppliers' credits outstanding was related to six countries, with U.S. credits responsible

started to negotiate a rescheduling agreement¹² with other institutions such as the "Hague Club" and the Eximbank.

To explain how the Brazilian government bailed out the private sector, the major borrower of suppliers' credit, we go back once more to the excellent research work provided by Donnelly (1970). When he presents the breakdown of the external debt of Brazil (Donnelly 1970: 96) we see that balance of payments credits (compensatory finance) jumped from US\$ 600 million per year, from 1954 till 1960, to US\$ 1115 million in 1961. This sudden increase is the result of the debt rescheduling program promoted by the Quadros Government. To better understand the bail out process promoted by the Brazilian state we quote Donnelly bearing in mind that "compensatory credits" (balance of Payments loans) are obtained only by countries' governments:

The rescheduling agreement that resulted provided from relief over a five-year period, 1961-1965. As obligations on supplier's credit came due to exporters in the various countries, Brazil received fresh loans (i.e., refinancing credits) from these governments in order to meet its obligations on schedule. Since these refinancing were really balance of payments loans, the liquidation of suppliers' credits- was thus accompanied by an increase in compensatory credit accounts as medium-term loans for balance of payments support (Donnelly 1970: 145).

Pres. Goulart and the Generals (1962-64)

In the words of Celso Furtado, a member of the Goulart government (1962-1964), the financial minister of this government, pressed by the IMF, BIRD, the Hague Club and Washington, had to renegotiate the foreign debt every three months and they seriously considered the alternative of rupture with IMF, as did Kubitschek (Bandeira 1978: 93). By early 1963, the President was inclined to a moratorium since the debt service became unbearable (Bandeira 1978: 109). The crisis that ended in the military overthrow of the elected President in the end of March 1964 is common knowledge and is outside the scope of our research. However, the negotiations and the rescheduling agreement of July 1964 reinforce our point about the shifting character of the Brazilian state.

As Donnelly (1970: 150) stresses this agreement covered basically medium term project credits of roughly US\$ 385 million falling due over a two-year period. Official project credits represented 24 percent and the remaining 76 percent were suppliers' credit,

for 30 percent.

whose breakdown against the total is as follows: Extended Hague Club (Japan) 46 percent and U.S. 30 percent.

In general, the mechanics of the refinancing with the majority of the creditor countries worked as follows: resources from individual governments, through official credits were available for 70 percent of the debt service payment due in 1964 and 1965. The remaining 30 percent the country was supposed to remit. Provided that Brazil would make debt service payments to original creditors in full, " the official agencies of these countries would, once proof of payment was presented, extend credits to the Banco do Brasil in amounts equal to the 70 percent of the effected remittances (Donnelly 1970: 145). Since the Banco do Brasil was the country's monetary authority it is easy to see the mechanics of the state assuming the private sector debt.

When we compare the 1961 and 1964 rescheduling agreement's its relevant to mention that in 1961 the refinancing was available without evidence of payments to the exporters. However the total debt relief for 1964 and 1965 was roughly three times that of 1961.

Finally, to stress our point of the State bailing out private credits related to suppliers' credit we quote Diaz- Alejandro, a major researcher of Latin America Economy, during this time:

One may question the desirability of mechanism used in industrialized countries, first to promote their exports of capital and other goods by liberal use of official insurance and credit schemes, and then to pressure recipient countries to consolidate private bad debts that are thus transformed into public debt on both the exporting and importing side, this system reduces entrepreneurial risk incentives to refine cost-benefit calculations and objectively to evaluate commercial risks. Diaz-Alejandro (1971: 449).

4. The Return of Private Bank loans and the debt crisis (1968-1982)

The increasing nationalization of the Brazilian external debt in the 1970s is of common knowledge likewise the burden of the Brazilian external debt in the 1980s. This burden was translated mainly by the exponential increase of the country's public internal debt and the consequent fiscal crisis engendered by it. Therefore, the following two sections just show a brief summary of the classical analysis presented by Cruz (1983) and

¹² The terms of the agreement and the amount involved can be found in Cabral (1962: 300).

Nogueira Batista (1983) on the subject of the shifting character of the Brazilian state in the 1968-1982 period.

4.1. The Brazilian Economic “miracle”- (1968-1974).

Since 1966, there was no need for compensatory loans due to the positive inflow of autonomous capital and foreign direct investment (FDI). It is also relevant to mention that private bank loans replaced the supplier’s credit of the late 1950’s and early 1960’s.

Pereira(1974:7) reports that the government intervention during this phase coined as the “debt administration phase” was to adapt the country legislation to changes that were taking place on the international capital markets. As previously reported the private sector was responsible for 67 percent of the total external debt. The information bellow illustrates this fact:

From 1966 to 1971 the breakdown gross external credits was as follows: 48 percent import financing and 52 percent international private banks credits. At least 65 percent of the import finance was related to public sector and state controlled companies’ investment in infrastructure and civil construction (Pereira 1974: 194). Regarding the bank loans we have an opposite situation with at least 73 percent of the private bank credits driven to the private sector.

4.2. The Nationalization of the External Debt (1975-1982)

The nationalization of the external debt (1975-1982)

In 1974, Swedberg (1987: 327) reports that debts of non-oil developing countries were about US\$135 billion. In 1982, at the time of the debt crisis that started with the default of Mexico in August, these debts skyrocketed to US\$ 500 billion in nominal terms and over 30 countries were in default. At the end of 1982, short-term debt amounted to about US\$ 130 billions. Brazil, for instance, was rolling over about US\$ 10 billion on a day-to-day basis. The Brazilian economy was captured (together with other developing economies) by international capital movements in search of new markets.

The Brazilian economy embarked on an ambitious import substitution program when the world economy was managing the result of the oil price shock. The growth-cum debt strategy resulted in an increasing external debt.

An impressive fact of the Brazilian external debt during the 1970s was the increasing "nationalization" of foreign obligations that started to take shape in 1977. This debt starts predominantly as a private debt¹³ and during the decade it is transformed into public external debt. In 1975, the private sector share on external debt dropped to 50%, while by the end of 1980, the public sector was responsible for almost 77.5% of the external funding obtained in 1980 (Cruz 1983: 72). From 1977-1978, the public companies start to fund themselves with foreign loans. They were used as a vehicle to roll over the foreign debt. The Central Bank required the banks to lend to the public sector (including state-owned companies) at least 30 percent of their assets. It's not the projects anymore that attracted the financing but the need to roll over the external debt that "create" the projects.

Another major element in the process of "nationalization" of the external debt was the introduction, in September of 1977, of RES. 432. Basically, RES.432 established a device of "socializing" the losses related to more accentuated exchange rate devaluation. For instance, in the case of companies indebted with foreign loans, this device proved to be very helpful by the time the "maxidevaluation" occurred in the end of 1979 (Cruz 1983: 89).

The original intention of RES. 432 was to reduce the increase of the monetary base due to capital inflows. RES. 432 allowed the banks involved in the lending of external resources to transfer their hard currencies debt to the Central Bank which in turn become responsible for almost all the costs involved. In this way the Central Bank assumed the position of the lender of last resort. The purpose of this device was to match the management of the external debt profile (minimum term for amortization of 8 years), with the short-term credit demand (minimum tenor of 3 months). If the banks could not get clients to borrow from their hard currency lending (minimum tenor of amortization of 8 years) they always had the possibility of depositing at the Central Bank these idle resources. Thanks to this device the banks that operated with RES. 63 type of loan (bank intermediate loans) were almost free from the exchange risk; in the absence of a client

¹³ The large local companies and shiftily the multinational companies were the major one's responsible for the first cycle of external borrowing in the 1970s (1969-1973).

there was always the possibility of transferring the risk to the Central Bank (Nogueira Batista 1983:140).

In 1982 when the external debt crisis erupted, the public sector was responsible for more than 70 percent of the external debt and the idea of socializing the losses and privatizing the profits inaugurated with the Taubate Convention in 1906 was one more time present. That is, the Brazilian public sector that was forced to be involved in the debt rollover in 1977-1978 had to manage alone the burden of heavy debt in a very unfavorable international situation. To make a long story short, these large amounts of external debt “were converted” into internal debt that in turn became the principal problem faced by the Brazilian economy in the 1980s.

5. The Return of Compensatory Finance (1990s)

1994-1998

A significant development in global finance in the 1990s is the growth of international portfolio investment (PI) in emerging markets. The growth of portfolio investment in Latin America, replacing the bank lending which precipitated the debt crisis of 1982, has reduced the credit constraint under which these economies have suffered since the early 1980s. It also opens the door for new attempts of stabilization. In the 1990s capital inflows combined with high economic activity and exchange rate appreciation favored stability.

Latin America region remained practically isolated from international capital markets from the time of 1982 Mexican moratorium and the signing of the first Brady Plan to the restructuring of the external debt of Mexico in 1990. One can say that the resolution of the debt crisis of 1982 was obtained via “securitization” (Brady Plan) and conversions. The Brady Plan was implemented by official agencies as IMF, World Bank and U.S. Treasury. The debt with international banks related to the 1982 debt crisis was “securitized” by its value on the secondary market, roughly 50 percent of its book value. This debt were negotiated and transformed into bonds. That is, the countries issued bonds (15 to 20 years maturity) backed by this debt. These bonds carried as a collateral US T bonds.

By 1993, the fall of international interest rates had eased the external debt burden and led to an agreement with creditor banks. This agreement was concluded in April 1994. Brazil was a latecomer to the Brady agreement; the exchange of instruments in debt stocks and arrears amounted to US\$12.1 billion debt with the Paris Club and to roughly US\$ 47.7 billion in commercial bank debt restructuring.

| Table 1- Gross External Debt | | | US\$ billion | | | | | |
|-------------------------------------|--------------|--------------|---------------------|--------------|--------------|-------------|--------------|-------------|
| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
| Registered | 110,8 | 114,2 | 119,7 | 129,3 | 144 | 163,3- | 203 | 203 |
| Nonregistered | 25,1 | 31,4 | 28,2 | 29,9 | 35,8 | 36,7 | 21,2 | 22,2 |
| Gross | 135,9 | 145,8 | 147,9 | 159,2 | 179,9 | 200 | 224,2 | 225 |

Source: For 1992 to 1995 Boletim do Banco Central (BBC), November 1996; for 1996 to 1997 BBC (June 1999); for 1998 to 1999, Boletim do Banco Central (BBC) Maio 2002

| Table 2- Private and Public Sector Share in the Gross External Debt | | | in percentage | | | | | |
|--|-------------|-------------|----------------------|-------------|-------------|-------------|-------------|-------------|
| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
| Public | 69 | 62 | 59 | 57 | 47 | 38 | 42 | 48 |
| Private | 31 | 38 | 41 | 43 | 53 | 62 | 48 | 52 |

In December 1997, Brazilian government granted a US\$ 1 billion credit line, for companies operating in the stock market, to buy their "undervalued" share due to the Hong Kong stock exchange turmoil of the second week of November. This follows a pattern of coffee valorization schemes of the beginning of the century since the Government was bailing out private losses. That is, in the risk of stock exchange crash the State was pressed to assume all the losses. For the time being the data available is small. However, this move tends to be bigger since an important share of the short-term capital flow was driven to the easy gains on the Brazilian stock exchange market.

Table 4-Private and Public share on the registered debt in US\$ billions

| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---------|------|------|------|------|------|------|------|------|
| Public | 86,6 | 83 | 87 | 90 | 84 | 76 | 92 | 97 |
| Private | 23,4 | 30 | 33 | 39 | 60 | 92 | 110 | 106 |

Source: For 1992 to 1995, Boletim do Banco Central (BBC), November 1996; for 1996 to 1997, BBC, June 1999; For 1998 to 1999, Banco Central annual Report, 1999.

Table 5- Private and Public share on the registered debt in percentage

| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---------|------|------|------|------|------|------|------|------|
| Public | 78 | 73 | 73 | 60 | 58 | 45 | 46 | 48 |
| Private | 22 | 27 | 27 | 40 | 42 | 55 | 54 | 52 |

From the chart above, at least roughly fifty percent of the registered public debt is related to the external debt carried over from the 1980's . This debt were negotiated and transformed into bonds (Brady Plan) that is, US\$ 47 billion debt restructuring with commercial banks and US\$ 12 billion with the Paris Club. If we discount from the registered debt of the public sector (as a rough estimate) US\$ 55 billion per year from 1994 to 1997 and US\$ 45 billion from 1998 to 1999 the total debt of the public sector incurred in the 1990s would be as follows:

Table 6 Adjusted Gross Public Debt in US\$ billions

| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|-------------|------|------|------|------|------|------|------|------|
| Public Debt | 86,6 | 83 | 31,6 | 35 | 29 | 21 | 47 | 52 |

Source: Table 5 and 6

It is important to mention that almost all the nonregistered debt until 1999 are from the private sector (related mainly to trade finance credit lines). Therefore, we can conclude that the *flow* of the Brazilian external debt in the period was driven to the private sector. The chart bellow illustrates this point:

Table 7 – Gross Private Debt in US\$ billions

| Year | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|--------------|------|------|------|------|------|------|------|------|
| Private Debt | 42,1 | 55,4 | 60 | 68 | 95 | 124 | 107 | 117 |

Source: Table 2 and 3

On the second half of 1998 the foreign exchange situation of Brazil became critical. The uncertainty increased and the private creditors of the country resisted to rolling over the debt that was becoming due. This fact, among others, explains the heavy loss of reserve experienced during this period. On the other hand, the negotiations underway with IMF, US Treasury, World Bank, etc, were signaling in the direction of a big financial rescue package. Therefore the conditions for a new wave of "debt nationalization" with the government bailing out the private sector was underway.

1999-2005

From 1999 to 2002 Brazil faced several speculative attacks, being the more important the following: a) the forced devaluation of the Real with the adoption of the floating exchange rate regime in February 1999; b) September 11 terrorist attack in 2001 in US with its repercussions to the emerging markets; c) the Argentinean melt down in the first semester of 2002; d) the uncertainty associated with October presidential election. The country has signed several agreements with the IMF involving resources in the amount of US\$ 86 billion (US\$ 41,5 billion in 1998-1999, US\$ 15 billion in August 2001 and US\$ 30 billion in September 2002). From this amount US\$ 55 billion were disbursed. In 2005 when Brazil paid in advance its debt with IMF.

The Table below illustrate the "nationalization of the Brazilian external debt" This aspect become clear if we consider that the share of the public sector in the Gross External Debt started to increase from 1998 and onward. However, what is more relevant is the presence (for the first time in the 1990s) of compensatory finance from 1998 onward. As a result of the several "rescue packages", the country disbursed US\$ 55 billion from the IMF. That is, the "nationalization" of the Brazilian external debt in the 1990s, contrary to similar process in early 1980s, follows the same pattern of the resembling process in the early 1960s.

6. Conclusions

Historically the Brazilian state bailed out the debt of the private sector during instable subperiods. This was the case of 1920-1931, 1956-1962 and 1975-1982. The

nationalization of the external debt is a consequence of an increasing economic instability coped with an increasing external debt of the country. The increasing share of the Public external debt can be seemed as a sign of a forthcoming debt crisis.

As for the current period (1994-2005), if we regard the impact of the IMF package loans, we can see that the country would not close its external account from 1998 onwards without “burning” additional strategic foreign exchange reserves. As we saw in **section 3** the use of compensatory financing is a sign of the return of the historical process of the Brazilian State bailing out the external debt of the private sector. This aspect become clear if we consider that the share of the public sector in the Gross External Debt started to increase one more time in 1998. That is, the "nationalization" of the Brazilian external debt in the 1990s, contrary to similar process in early 1980s, follows the same pattern of the resembling process in the early 1960s.

Table 8 Brazilian External Debt from 1998 to 2005

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|--|-------|-------|-------|------|-------|------|-------|-------|
| Gross External Debt (GED) in US\$ billi (1) | 224 | 225 | 217 | 210 | 211 | 215 | 201 | 169,4 |
| Public in US\$ bill. (2). | 92 | 101 | 100,5 | 103 | 110,5 | 111 | 125,2 | 96 |
| Public` % | 42 | 45 | 46 | 54 | 52 | 52 | 62 | 57 |
| Private in US\$ billi.(3) | 128,8 | 124,8 | 116 | 106 | 90,1 | 79 | 76,1 | 73 |
| Private in % | 58 | 55 | 54 | 46 | 48 | 48 | 38 | 43 |
| IMF(4) in US\$ billi. | 9,4 | 12,3 | 1,8 | 8,3 | 21 | 28 | 25 | 0 |
| GED % GDP (5) | 28,4 | 42 | 36 | 41,2 | 45,9 | 42,4 | 33,3 | 21,4 |

Source: (1) for 1998 and 1999, Boletim do Banco Central (BCB), May 2002; for 2000 and 2001, BCB May 2004; for 2002 to 2005, May 2006. (2) **Source:** the same as (1) but from 2000 onwards adding “setor publico financeiro” (public financial sector) obtained from Banco Central do Brasil Annual Report (BCBAR) for the respective year. (3) **Source:** the same as (1) but from 2000 onwards subtracting “setor publico financeiro” (public financial sector) obtained from Banco Central do Brasil Annual Report (BCBAR) for the respective year. (4) **Source:** BCBAR 2001 and 2005, for 1998 and 1999 includes BIS loans of respectively US\$ 4,7 bill. and US\$ 3,1 billion; (5) **Source:** BCBR 2005 for 2001 to 2005, Remaining years, “Indicadores Economicos” of the Brazilian Central Bank as of March 2003.

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