Brazil is likely to be the next 'big one'

by Dennis Small

Back in 1982, the then-President of Mexico, José López Portillo, said the following at the United Nations on Oct. 1: "Either a new world economic order is accepted, or civilization will sink into a new medieval Dark Age with no hope of a renaissance."

So, even back then, the issues which we now face today, more starkly, were recognized by some at that time. And, it should be noted that those "some," such as López Portillo, were in touch with Lyndon LaRouche, who had met with him just a few months prior to his Oct. 1 remarks.

For those of you who have had a chance to look at the Call for a Union of Sovereign Nation-States, you'll notice, lawfully enough, that ex-President López Portillo is one of the initiating signators of that call.

What I'd like to focus on today, is the situation in Brazil, because this is most likely the next "big one" that's going to blow up financially.

We have entered the zone of sovereign defaults (**Table 1**). As noted by John Hoefle, with the so-called second phase of the Asia crisis, we are coming into a situation where entire nations, the debt of governments and related debts of entire nation-states, are blowing up. In July 1997, it was Thailand, with perhaps $95 billion of official foreign debt, but with a *real* foreign debt—in other words, categories that aren't officially counted but are de facto foreign obligations—of perhaps $110 billion. This is not really a large amount, relatively speaking.

TABLE 1
Sovereign defaults
(billions $)

Date	Country	Official foreign debt	Real foreign debt
July 97	Thailand	95	110
Aug. 97	Malaysia	40	50
Dec. 97	South Korea	158	170
Jan. 98	Indoneasia	137	150
Aug. 98	Russia	140	180
—?, 1998	Brazil	263	481

Then, Malaysia, just a month later, in August, was put in the barrel, with a total of about $50 billion. In December 1997, everyone remembers what happened over Christmas with South Korea: It blew up, with perhaps in the range of $170 billion at stake. Indonesia then jumped into the barrel, or rather was pushed into the barrel, in the early part of 1998, and President Suharto was eventually overthrown as part of this process. Here, perhaps $150 billion in debt exploded. And now, we're in the throes of the Russian sovereign default. The official foreign debt of Russia is $140 billion, while the real foreign debt is perhaps in the range of $180 billion.

Next comes Brazil, in the weeks and months immediately ahead. The official foreign debt of Brazil is going to be $263 billion at the end of 1998. But, when you add in the other categories of de facto foreign obligations, such as dollar-denominated domestic debt and so forth, you're talking about a real foreign debt bubble of $481 billion—close to a half-trillion dollars, which, as John so eloquently put it, is about to go, "Poof!"

Now, that's big. This is nearly three times the size of the Russian debt bubble. And as can be seen in **Figure 1,** *the exposure of United States banks in Brazil, and Ibero-America in general, is greater than either in the Asian situation or in Russia*. In all of Asia, U.S. banks have about $35 billion of direct exposure. Mind you, this excludes consideration of derivatives: We are leaving derivatives aside, because that has an incalculable multiplier effect. We're talking about just direct sovereign-type default.

In the case of Russia, U.S. banks have "only" $8 billion in exposure. Of course, the strategic implications of Russia

FIGURE 1
U.S. bank exposure
(billions $)

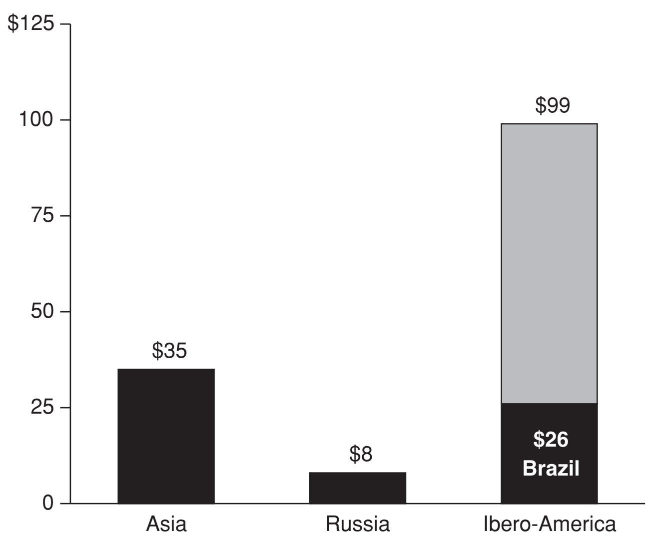


FIGURE 2
Brazil: real foreign debt
(billions of $)

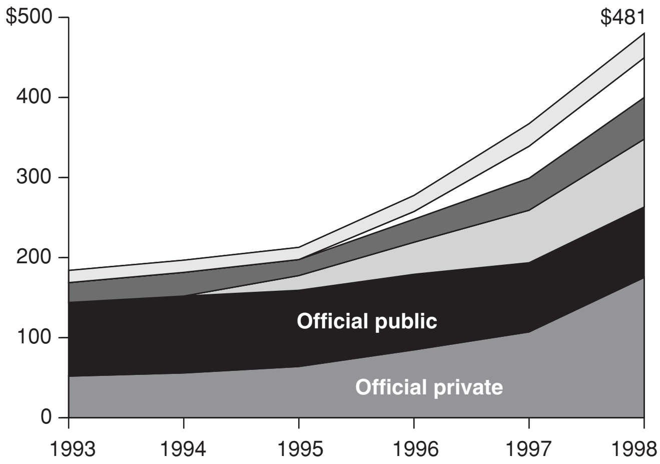
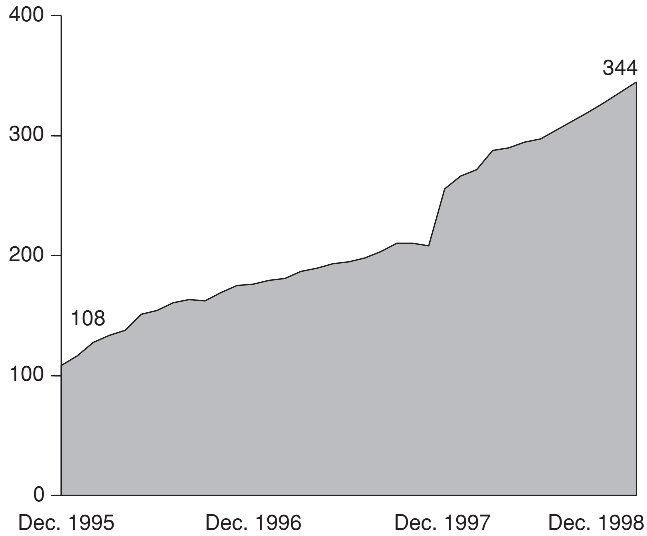


FIGURE 3
Brazil: treasury bonds
(billions of reais)



go far beyond anything that we've seen yet to date, including the Brazilian situation. But it is useful to look at the financial magnitudes, to get a mental image of what's about go "poof!" here.

In Brazil alone, there is $26 billion in U.S. bank exposure. In other words, *the U.S. banks have at stake directly 3.3 times as much in Brazil, as they have at stake in Russia*. So, if the size of the debt bomb itself is nearly three times larger in Brazil than in Russia, and if U.S. bank exposure is 3.3 times greater in Brazil, then even simple arithmetic shows that you're talking about a debt explosion of ten times greater direct impact on the U.S. banking system. Again, this is only direct, immediate impact; it is not reverse leverage, not derivatives, none of that. Just the direct, immediate impact of the Brazil blow-out on the United States banking system.

If you look at all of Ibero-America—which, by the way, will go in chain-reaction directly after Brazil—Argentina, Mexico, and so on, then you have $99 billion of United States bank exposure.

The Brazilian bubble

Now, let us analyze the Brazilian debt bubble, and see what it looks like. **Figure 2** shows the growth—not just the size, but the rate of growth—of the official Brazilian foreign debt, and the de facto foreign debt on top of that. The bottom two segments are the official debt, and the remainder are other categories of de facto foreign obligations, totalling $481 billion.

Now, that's bad, but it is still not the main problem. That is not where the explosion is likely to start in Brazil. In **Figure 3,** we see not where it is *going* to start, but where the meltdown *has started already,* even as we speak.

These are Brazilian treasury bonds. From December 1995, when there were about 108 billion reals worth in circulation (there are about 1.18 reals per dollar), through November 1997, they grew at the rate of "merely" 40% per year. Since that time, until June 1998, the annualized growth rate has increased to about 100% a year. You have a situation of a debt bubble which is out of control, and is already blowing up. The problem is not only the size of the bubble—at current rates of growth it will hit about 344 billion reals by the end of this year—but its composition, which is changing rapidly even in the few weeks since Helga Zepp-LaRouche was in Brazil, in mid-August of this year.

One big problem is that 30% of this domestic debt bubble is denominated in dollars, i.e., about one-third of it has to be repaid in dollars. In other words, they need foreign exchange to do it. Sixty percent of the debt bubble has what is called "post-fixed" interest rates, which means that the interest rate on the bond that you buy is set at the *end* of the term, i.e., when it matures. That way, if interest rates *increase* over the term of the bond, you, the bondholder, get more money. Lucky you—if, of course, there's a casino house still standing to cash in the chips. Sixty percent at this point are post-fixed.

Then, the average maturity on all the bonds is nine months. Now, just straight arithmetic tells you that, with this amount of bonds maturing over a nine-month period, you have, on average, approximately $7 billion worth of bonds coming due every week. Every week that has to be rolled over.

Well, guess what? The markets aren't buying Brazilian bonds any more, at least not at any interest rates that the government can pay. Now, the experts say: "Well, no problem; Brazil's got $70 billion of reserves." That was, of course, a week ago. Now it has $60 billion of reserves, and dropping.

Londoño denounces British plot to dismember Colombia

Maximiliano Londoño, president of the Ibero-American Solidarity Movement in Colombia, described to conference participants how narco-terrorists have brought his country to the brink of disintegration, and showed how that destruction flows out of long-standing British plans to dismember all the nations of the Americas.

Londoño also brought "fraternal greetings of friendship" to the conference from former Presidential candidate, Gen. Harold Bedoya (ret.). Bedoya wished the best for "the important work you are undertaking today, regarding the problems of economics and violence that are afflicting the world. Colombia, a country threatened by indiscriminate globalization, drug trafficking and terrorism, needs international understanding and support, in order for life, freedom and democracy not to perish, and Latin America along with it," Bedoya's message read. "During the recent Colombian Presidential elections, I proposed a 'Marshall Plan' with international participation to achieve the moral and economic recovery of the country," adding that he continues to represent "the democratic opposition against the drug trafficking and terrorism that reigns today in Colombia."

At this current rate of loss of reserves, and turning in bonds at the rate of $7 billion per week, those $60 billion of reserves could last perhaps eight weeks, nine weeks, something like that—*if the pace does not accelerate,* which it is.

The government of Brazil is acting like they aren't concerned about this, because there are Presidential elections on Oct. 4, and all they want to do is get to those elections. And then, if President Fernando Henrique Cardoso gets re-elected, he will hand over the country's wealth entirely, to deal with this debt issue.

So, Brazil is on an extremely short fuse to a blowout. A member of the New York Council on Foreign Relations, Albert Fishlow, recently noted that there is a lot of discussion around the world about capital controls and exchange controls. He argued that it is very dangerous that this has been raised by the likes of Dr. Mahathir bin Mohamad of Malaysia, but *should this catch on in a country like Brazil, the system is really finished.* Because Brazil is very big, and very dangerous, Fishlow explained. And, he's right.

Infrastructure and integration

Brazil is a very great danger, in one sense, to the financial system. But, Brazil is also a country of enormous potential: political potential, economic potential, and it can in fact be the engine for movement and leadership in Ibero-America and throughout the Third World in a significant way.

Brazil is a nation of 170 million people. Brazil is larger than the continental United States in land area (if you throw in Alaska and Hawaii, the United States is larger). Brazil is the ninth-largest economy in the world. It has an *enormous* industrial sector in its own right. And, most importantly, it has very significant advanced technology capabilities as well—or had, until the recent takedown of some of these—in the nuclear area, and in the aerospace area. It also has capital goods production.

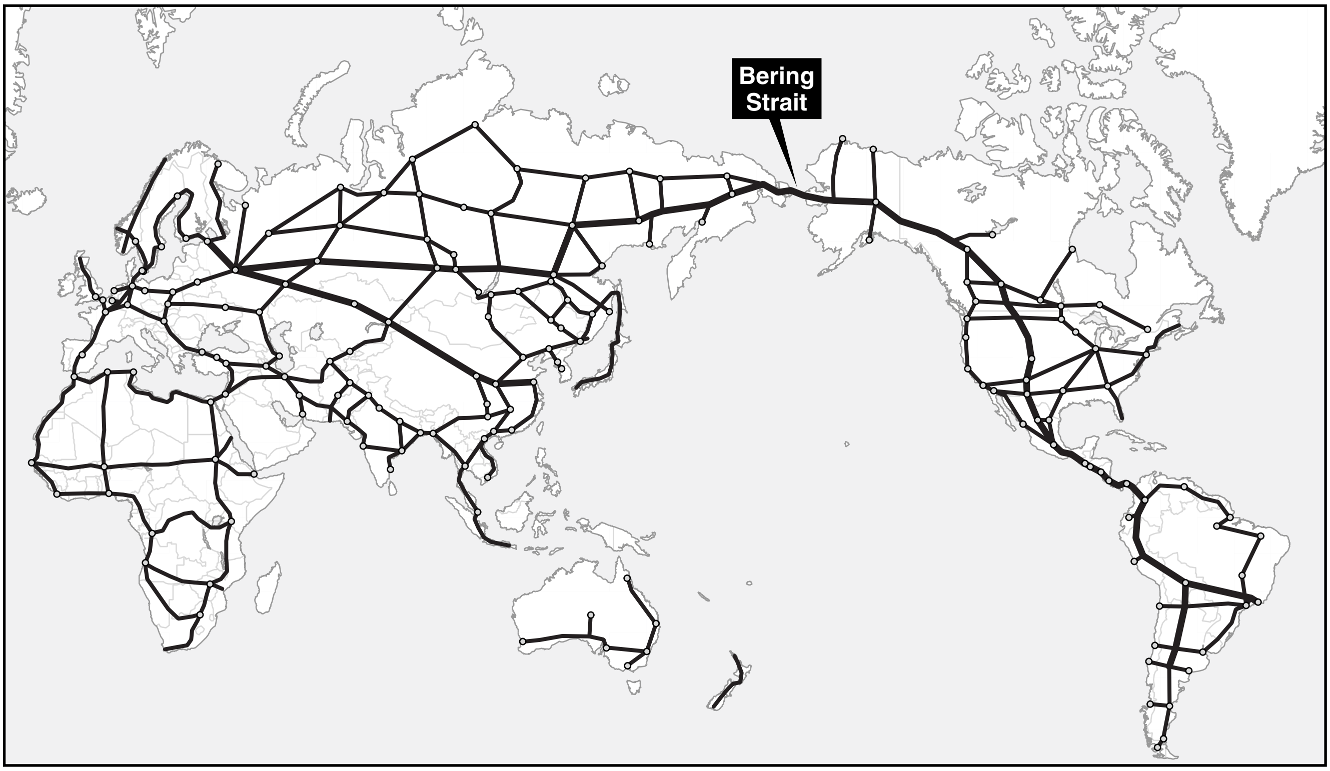
Brazil lacks, as LaRouche has explained, real capabilities in terms of machine-tool production. But the potential for that absolutely exists in Brazil, because of the existing level of development—which, of course, co-exists along with terrible poverty in most of the country. But, it has tremendous potential for real economic development.

Now, Helga Zepp-Larouche was just down in Brazil for about a week. One of the things that has not been publicly reported on, only because there wasn't space or time to report on everything, was that the very first meeting which she had on arrival, was with a gentleman, an engineer, by the name of Prof. Vasco Azevedo Neto, who is professor emeritus at the Polytechnic Institute of the Federal University of Bahia.

This was a very interesting meeting, because Professor Vasco has developed and published an entire proposal for the infrastructural development, not only of Brazil, but of the entire South American continent, a proposal which is based, as he explains in the introduction, on "the theories and forecasts of the polemical American politician and economist,

FIGURE 4
South America: great water projects

FIGURE 5
Main lines of a worldwide rail network, as sketched by H.A. Cooper



Lyndon H. LaRouche."

Another notable fact about Professor Vasco is that he is currently a Presidential candidate in the Oct. 4 elections. Now, he does not have any real chance of winning. However, there's another Presidential candidate, whom I'll say a little bit about in a moment, who does.

What Professor Vasco has developed—and this goes way back before he knew us, to the 1960s and 1970s—is a concept of developing continental great waterways and railroads to open up the interior of Ibero-America to development, based on what he calls "the paths of least resistance." In other words, you have to find, within the natural geography and "physical economy," as he puts it, those pathways of least resistance for the infrastructure, which will lead to the greatest rates of economic development. It's actually a concept very close to that of Leibniz's "least action principle."

In **Figure 4** you can see *EIR*'s representation of proposed water development projects for South America. Professor Vasco presents similar maps and proposals, emphasizing what he calls the "Great Waterway." This is a water transport system which would connect the river systems of the Orinoco in the north, with the Amazon system in the center of the continent, and then down into the Rio de la Plata system in the south.

There are two principal connection points that have to be developed: One, where the Orinoco links up with the Amazon, which is in a region called the Casiquiare, which is the headwaters of *both* river systems. I've never been there, but I'm told that this is one of the most fascinating geographical areas on the face of the earth, because you have water that comes from underground springs, and flows in two opposite directions simultaneously. So, you need a canal system to connect these two systems, and thereby make the entire area navigable. Further south, going down the Amazon system, you can link up to the Paraná/Rio de la Plata system in the Guaporé rapids area, if you also construct canals and so forth.

If you do this, you have an internal navigable waterway which is 9,800 kilometers long. That's about 6,000 miles. Think back to what we heard in other panels at this conference about the importance of opening up the Ohio and the other river systems in the United States, and you can see how crucial this is for South America.

Interestingly, the idea of linking up these three river systems, historically, was associated both politically and economically to the idea of opening up the waterways in North America. It was actually Alexander von Humboldt who was among the first to propose connecting these three river systems, then leading out into the Caribbean, travelling up the Mississippi River, and from the Mississippi, through canals, connecting to the Great Lakes system of the United States. His idea was one of *integrated continental development,* and this is the way it actually has to be done today, as well.

What *EIR* has added to Professor Vasco's waterway proposal, is that there must not only be great infrastructure development projects, but that you also have to have corridors of development which are carried by these infrastructure projects, which is LaRouche's concept for the European Productive Triangle and the Eurasian Land-Bridge.

The shaded area in Figure 4—southern Brazil, Uruguay, and northern Argentina—is what we have called the "Productive Axis" of South America. It is only 12% of the total land area of Ibero-America, but it has 26% of the population, 40% of the electricity production of the continent, and 44% of the manufacturing. It is the most economically dense region, and it has to be the motor which spreads development—technology and labor-force development—throughout the interior of the continent, through not only this Great Waterway, but also through an integrated continental railroad system, which has the crucial advantage, unlike the Waterway, which can't go over the Andes Mountains, of linking South America up with the Pacific Basin and the Eurasian Land-Bridge.

The existing railroads of Ibero-America are relics of colonialism. The railroad density (kilometers of rail per square kilometer of land area) is one-sixth that of the United States, and one-thirteenth that of France. Moreover, there are six different gauges in Ibero-America, such that, on the existing rail systems, you cannot interlink the traffic of one country to another. This was an intentional colonial policy, to have rail lines running only from the mines, to the ports, for export of raw materials.

It is an economic and political necessity to link such great development projects of Ibero-America, to the Eurasian Land-Bridge, and more broadly to the proposed Union of Sovereign Nation-States, as has been discussed throughout today's proceedings (see **Figure 5**).

The political task at hand is one that is absolutely feasible. The current governments of Ibero-America are, by and large, weak and bad, as they are in many parts of the world. But, there are some past Presidents who are not so bad, and are helping to lead the way, such as the case of Mexico's López Portillo. And, we are confident, there are some *future* governments and Presidents that are not so bad either.

In this regard, I would simply refer to the case of Brazil's Dr. Eneas Carneiro, the Presidential candidate who hosted Helga LaRouche on her recent trip to Brazil. In an educational pamphlet of his, entitled "Brazil in Danger," Dr. Carneiro notes simply: "There is only one solution, and that is to break with the international financial system, including the IMF, the World Bank, and the World Trade Organization."

Give the children back their dreams!

by Gail G. Billington

Two developments in the past week graphically underscore the theme of this panel—the two paths for humanity: descent into a New Dark Age, or a return to economic and cultural sanity through the New Bretton Woods and Eurasian Land-Bridge policies outlined by Mr. and Mrs. LaRouche.

On the side of the New Dark Age, we have the Aug. 31 report of the International Labor Organization that in 1999, some 66% of Indonesia's more than 200 million people will slip below the poverty line—2 out of 3 people. As the report says, this is "poverty levels not seen since the 1960s."

Please recall that in October 1997, then-President Suharto was given the UN award for poverty eradication, having reduced the number below the poverty line to 11%—better than poverty figures here in the United States. The ILO report confirms that 35 years of progress have been wiped out in Indonesia.

Similarly, the famine in North Korea has claimed the lives of at least 2 million, and possibly up to 6 million people—2 million would be 1 out of 12 people; 6 million would be almost 1 out of 4.

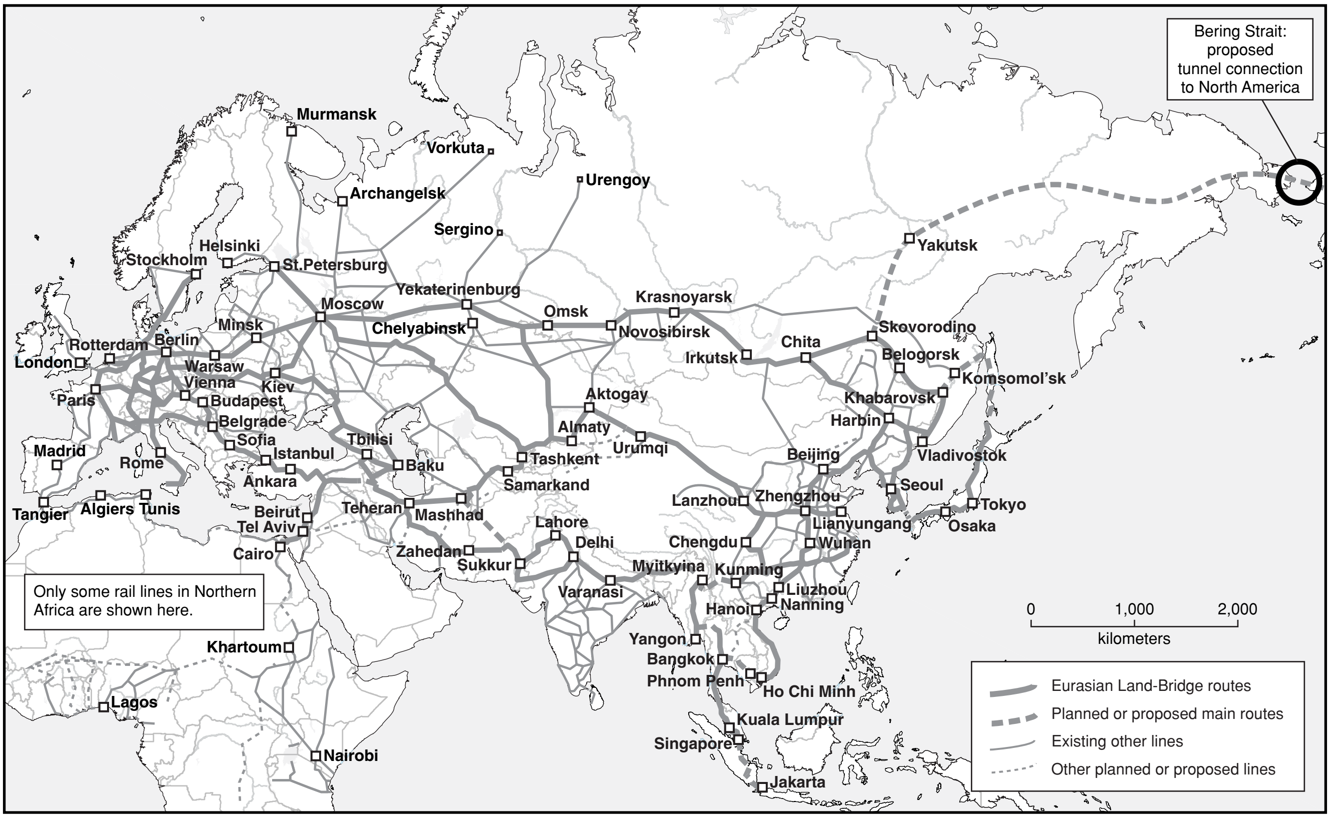
The second development, is the move by the Malaysian government to shut down the ability of speculators to continue to loot that country, through attacks on its currency and stock market. Prime Minister Dr. Mahathir bin Mohamad has made the turn toward economic sanity, over the objections and obstruction of his now former Deputy Prime Minister and the former central bank head.

Sept. 20 marks the first anniversary of Dr. Mahathir's keynote address to the annual International Monetary Fund (IMF) meeting in Hong Kong, in which he became the first sitting head of state to publicly espouse what *EIR* has said all along about the global financial crisis: that the world economy has been overtaken by speculation, and has been decoupled from providing for the general welfare of the population, and that this is leading to a new form of colonialism. He has also said, and as a sitting head of state, uniquely so, that the only solution must be a global overhaul of the financial system.

On the eve of that IMF meeting, the *Wall Street Journal* ran a front-page article in its Asian and European editions, charging that Dr. Mahathir was listening to LaRouche. In

FIGURE 1

Eurasia: main routes and selected secondary routes of the Eurasian Land-Bridge



its lair on Wall Street, the *Journal* didn't say a peep.

I want to read you an excerpt from Dr. Mahathir's speech on Nov. 2, 1997, describing the world economy:

> A world trading system cannot rely on market forces. It is time that we draw up fair rules for the market place. If we don't, then the fight for independence will have to begin all over again, for the present market rules will surely result in a new imperialism more noxious and debilitating than the old.

And, let me make clear what Malaysia has done with the controls imposed last week. The following excerpt from the Sept. 1 Bank Negara release makes absolutely clear Malaysia's understanding of what is required, and to what extent any national measures will solve the global problem:

"2. . . . While arguments have been put forward for emerging economies to undertake economic and financial reforms, of greater urgency is the need to reform the international financial system to better cope with the changed international financial environment that we operate in. *Unless this is recognized by the international community, there will not be a permanent solution to the current crisis.*

"3. *Efforts to deal with the current situation on the part of one country alone will not be sufficient to achieve this objective on a permanent basis* [emphasis added]. . . .

"4. The overriding objective of the new measures is to regain monetary independence and insulate the Malaysian economy from the prospects of further deterioration in the world economic and financial environment. . . ."

Pawprint of the New Dark Age

I shall briefly indicate exemplary evidence of the approaching New Dark Age, as a result of the utter failure of the IMF system.

1. *Unemployment: Record rates of unemployment are being recorded across the region.*

In Indonesia, the economy will collapse 10%, and perhaps up to 20% this year, with inflation running officially at 80-85%, unofficially at 100% or more. In June, Manpower Minister Fahmi Idris warned that unemployment would rise to 17% (15 million) of the 90 million workforce. One coauthor of the ILO report warned that unemployment could possibly rise to 20% (18 million), with half of those seeking