Bush Team Panics, Bails Out Brazil's Creditors

by Gretchen Small

Democratic U.S. presidential pre-candidate Lyndon LaRouche was blunt, in an Aug. 8 interview: The $30 billion International Monetary Fund package for Brazil announced Aug. 7, is actually meant to bail out Brazil's principal creditors, such as Citibank, J.P. Morgan Chase, and other major international banks.

"Washington is bluffing," said LaRouche. "The Bush Administration has no idea at present of what to do about the global systemic crisis, nor the specific danger of a Brazilian debt blow-ut. What they do know is that they don't want Citibank and J.P. Morgan Chase to go under—*that* they know.

"The danger of an imminent Brazilian default—with its $500 billion real foreign debt and an out-of-control domestic public debt bubble—was too big to digest. The entire system could blow out at a moment's notice.

"So this IMF package is not a favor to Brazil; it is a favor to a United States that doesn't know what the hell else to do under these circumstances. It has to be understood that way. Obviously, in this situation, they are going to try to bail out Citibank, J.P. Morgan Chase, and probably some other U.S. and European banks as well."

U.S. banks had some $32 billion at risk in Brazil as of March 31, 2002, with CitiGroup's exposure said to be close to $13 billion of that total. And European banks have some $82 billion, with Spanish interests the most exposed by far. And that does not include the foreign corporate investment tied up in Brazil, with U.S. corporate assets in Brazil estimated by Brazil's Central Bank to have been over $55 billion at the end of 2000.

Make Those Policy Failures Bolder!

Since taking office, U.S. Treasury Secretary Paul O'Neill insisted that mega-bailouts were a thing of the past. A few slipped through (notably Turkey, considered strategic for an attack on Iraq), but the hard- ine certainly held in Ibero-America. By late July, however, it became evident that Brazil was careening toward default. This was the predictable result of the fact that its foreign creditors, going down themselves as the global financial system collapses, had written Brazil off earlier in the year—quietly, but systematically cutting it off from foreign credit.

When the Uruguayan banking system collapsed in the last week in July, the financiers then faced the immediate possibility that neighboring Uruguay would have no choice but to join Argentina in declaring default on its sovereign debt.

Uruguay's nearly $7 billion in foreign debts are small potatoes compared with Argentina's or Brazil's, but a second Ibero-American default, of any size, could not be risked. The crisis also coincided with O'Neill's scheduled Aug. 4-7 visit to Brazil, Uruguay, and Argentina. Over the weekend of Aug. 3-4, the U.S. Treasury provided a $1.5 billion bridge loan to Uruguay, to be repaid by the IMF and Inter-American Development Bank when their boards officially could meet to approve the bailout. That allowed Uruguay to partially reopen its banks on Aug. 5, although depositors in Uruguayan public banks found three quarters of their dollar deposits were frozen for three years, at the IMF and the U.S. Treasury's insistence.

Good, but not good enough, hysterical financiers responded. London's *Economist* and the Executive Director of the financially shaky HSBC bank, Sir Keith Whitson, joined mega-speculator George Soros in calling for money to be thrown at Brazil. The *New York Times* chimed in, with an alarmed article on Aug. 5, warning that Brazil faces "mass corporate defaults." The Brazilian private sector owes an estimated $120 billion in foreign debt, a sum significantly larger than the $95 billion in Argentine official debt which went under in December 2001. The *Times* warned: "When a giant falls, the noise is loud and the collateral damage wide."

None expressed the panic of the financiers more colorfully, however, than the Aug. 7 lead editorial of the *Washington Post*, which screeched that the biggest, boldest bailout possible was necessary, if O'Neill "wants to head off the disaster of a meltdown in Brazil. . . . If you're going to do bailouts, you need to do them wholeheartedly, early, and potentially on a grand scale."

Throwing More Paper at a Forest Fire

The official announcement came later that same day: the IMF had reached an accord with Brazil's Cardoso government for a $30 billion loan to Brazil, the IMF's largest single bailout ever. Larger bailout packages have been arranged before, but always involving Group of 7 countries and the other multilateral banks. The $30 billion is solely from the IMF. Brazil is said to be negotiating with the Inter-American Development Bank and World Bank for yet more funds.

The loan is a two-part package. The IMF is to make $6 billion available as soon as its board approves the deal in September, with the other $24 billion to follow after the new President of Brazil takes office in January 2003—and it is contingent on that next President following IMF rules. But on top of the $6 billion being made available immediately, the IMF has agreed to allow Brazil to lower the amount of foreign exchange it must hold in reserve, from $15 billion down to $5 billion. Since the Central Bank reports Brazil currently has $23 billion in reserves, it can now use $18 billion of those reserves, plus the new $6 billion from the IMF, to throw at the "markets" and help bail out Citibank et al.

The principal conditionality of the program, is that Brazil maintain its primary budget surplus. This has been one of the chief mechanisms killing Brazil's real economy. Calculated as government revenue minus all expenditures *except* debt service, the so-called "primary" surplus translates—in real life—into a mechanism by which the government is forced to brutally cut back necessary expenditures, to ensure that billions are available to be transferred into debt service.

The new IMF accord requires that the next government maintain the current target of a primary budget surplus of "no less than" 3.75% of GDP—today equivalent to $19.2 billion a year—but leaves the door open to raising the percentage to be gouged out, by requiring the IMF to "revisit" the primary surplus target quarterly. And, although the accord only covers a 15-month period, it requires that the "no less than 3.75% primary surplus" be included in the budget laws for 2004 and 2005, two years after the accord would nominally terminate!

The IMF statement expresses confidence that the accord will be accepted by the leading Presidential candidates. In other words, candidate support for the accord is also a de facto conditionality. How much support will be considered good enough? Finance Minister Pedro Malan suggests that "if the principal candidates express clearly, unequivocally, with conviction, and in a credible form that the IMF accord benefits the country, 'it would facilitate things a lot,' " *GloboNews* reported.

Default Will Happen Anyway

The opposition candidates scrambled. Any candidate who rejects the pact risks being tarred as "the cause" of the Brazilian default which is going to happen anyway, while approval could bring political death, since the population despises the IMF policies. The would-be militant Luis Inacio "Lula" da Silva, a leader of the Pôrto Alegre-based "anti-globalization" forces, groveled. He welcomed the IMF package, called it "inevitable" and necessary to "calm down the financial system." His Vice Presidential running mate, Sen. José Alencar, a businessman from the right-wing, Mont Pelerinite Liberal Party, didn't need to see any details to declare the accord to be "a commitment by Brazil, and it will have to be maintained."

Ciro Gomes, running on the slate of the Laborite Front and vying with Lula for first place in the polls, came up with the formulation that he would not be the one to block Brazil's negotiations, nor would his government "promote the wrong future economic policies."

Gomes' formulation leaves a lot of room to maneuver. Repeatedly, IMF spokesmen insist that the new accord is based on continuing the current policies, which are the right ones. "The question is: If the policies are good, why are we having the crisis?" a Brazilian journalist asked IMF spokesman Thomas Dawson at an Aug. 1 press briefing.

The same question was raised in the lead editorial of the Aug. 8 German edition of the *Financial Times*. Headlined "Final Nail in the Coffin for IMF Ideology," the editorial by Sebastian Dullien notes that the crisis in Ibero-America, and Brazil in particular, is completely "demolishing the theoretical foundation" of IMF policies. Brazil has had a free-floating currency since 1999. Its Central Bank fought inflation. The government carried out economic reforms. Nevertheless, the national currency, the real, "is crashing," and with every devaluation of the real, the debt burden rises and default comes closer.

The editorial drew the proper conclusion: "The Latin American crisis is putting into question the entire modern world monetary system." Perhaps, this is the time "to think about a new world monetary system."

LaRouche: Freeze the Paper!

In his Aug. 8 interview, LaRouche laid out the parameters for what must be done to maintain a structure for a viable economy and society, while the bankruptcy is addressed. "Obviously we need stability; we don't want chaos. But this approach of throwing yet another 'wall of money' at a gigantic speculative bubble, is not going to work. The IMF is a dead institution; it no longer functions. Only one thing will work: You're going to have to freeze the situation by freezing everything, including these debts. You cannot bail it out, you cannot manage it. You can only deep-freeze it. Then you can manage what you've deep frozen. You are going to have to do it in the interests of the international as well as the national communities, as an overriding concern."

"In Brazil, as long as the dollarization of its debt continues, nothing is going to work," LaRouche emphasized. "The only thing you can do is freeze the unpayable debt. Then you have to go to a fixed exchange rate, which you defend with exchange controls and capital controls. That's the only way: you have to defend a fixed value of the Brazilian real against the dollar, and put an end to the free convertibility between the two currencies. With that in place, you then activate domestic credit mechanisms to keep the nation's vital real economy alive.

"The system is finished, and people have to recognize it. The IMF system is dead: it can't handle this crisis. You need a solution that will stabilize the situation, and actually work—these tricks are not going to do it. There is no solution in this system.

"The problem is that nobody in the U.S., at present, in official circles, has any confidence in their ability to manage this situation. So what they are doing is trying to bluff their way through."

LaRouche concluded: "We have the only solution—my solution. It's a rough one, but it's the only one that will work. Instead of trying to figure out how you're going to negotiate a new system, you just have to impose a solution which freezes the situation and makes it manageable.

"And if you haven't got the guts to do it, bring in a player, namely me, and I'll do it. I'll show you how it's done."