The day that was: Brazil debt crisis triggers global panic

by Dennis Small and Lorenzo Carrasco

It was "Friday the 13th," two days early.

On Wednesday, Jan. 13, exactly two months to the day after Brazil and the International Monetary Fund (IMF) announced their agreement on the terms of a $42 billion bailout package, Brazil's debt bomb exploded, the world financial system began to blow apart, and those who foolishly thought they could ignore Lyndon LaRouche's warnings and "crisis manage" their way out of the mess, were again scrambling hysterically.

On Jan. 6, Itamar Franco, the newly inaugurated governor of Brazil's second most important state, Minas Gerais, had imposed a 90-day debt moratorium on payments to the federal government; the economic and political tinderbox that had built up in Brazil began to ignite.

At 9 a.m. on Jan. 13, the Fernando Henrique Cardoso government of Brazil made two announcements: First, that the current head of the Central Bank, Gustavo Franco, had resigned, replaced by Francisco ("Chico") Lopes, the Central Bank's erstwhile director of monetary policy. And second, that the Central Bank was lowering the trading band in which Brazil's currency, the real, is allowed to float by 9%. The real immediately fell by nearly 9% against the dollar.

World markets plummetted, as the news went around the world. The Dow Jones index dropped by more than 200 points at its opening. The São Paulo stock market was shut down briefly by "circuit breakers," after plunging 10%.

At 12:40 p.m. Brazil time (10:40 a.m. Eastern Daylight Time), President Bill Clinton made a short statement from the White House, announcing that he had received a briefing from Treasury Secretary Robert Rubin and his economic team "on the situation in Brazil, and on the developments in the world markets. We are monitoring the developments closely, especially what is going on in Brazil," President Clinton reported. Deputy Treasury Secretary Lawrence Summers cancelled a planned trip to New York City, in order to work on the crisis, hands-on, from Washington.

By the end of the day, more than a billion dollars had fled Brazil.

The next day, Thursday, even more capital fled Brazil (upwards of $1.5 billion, according to some accounts), bringing capital flight for January up to $5 billion, and reducing reserves to just over $30 billion; stock-market and exchange-rate instability began to spread across Ibero-America; and government and financial leaders around the world urgently consulted on what to do.

Then, on Friday morning, all hell broke loose.

At the 9 a.m. opening of markets, the Brazilian Central Bank set the new floor for the real at 1.40 to the dollar—down from its Thursday close of 1.32. But within a half-hour, the stampede to buy dollars and flee the Brazilian financial system was so great, that the government had to announce that it was allowing a free float of the real—the floor's the limit.

Within two hours, at 11 a.m. local time, the real had dropped to 1.51 to the dollar—an additional 14% devaluation vis-à-vis the dollar. By the end of trading on Friday, the real settled back to 1.45, a 20% drop over two days.

By noon, Finance Minister Pedro Malan and Central Bank director Lopes were on a plane to New York City—to work out with Wall Street and London bankers what comes next, and how to handle things when markets reopen on Monday morning.

'A breach in the firewall'

Earlier in the week, at a Tuesday breakfast meeting at Blair House in Washington, during a two-day state visit by Argentine President Carlos Menem, he conferred with U.S. Treasury Secretary Rubin, IMF Managing Director Michel Camdessus, World Bank head James Wolfensohn, Argentine Finance Minister Roque Fernández, and others in what the Argentine media called a "prayer session" to come up with a

Brazilian President Fernando Enrique Cardoso is faced with fighting an uphill battle on behalf of Brazil's predatory international creditors, against his own nation.

solution to the Brazil crisis.

Governments and media around the world were equally hysterical. "Red alert . . . to avoid a Russia-style financial meltdown," warned the British wire service Reuters. "The much-feared Hell: Brazil devalues," wailed an Argentine daily. "It's a breach in the firewall that we spent months building around Brazil," protested a top economic adviser to President Clinton.

Counterpose this hysteria to the unambiguous forecast issued by Lyndon LaRouche in his year-end strategic study "When Economics Becomes Science" (*EIR,* Dec. 18, 1998), in which he warned precisely about the nature and timing of the next, ratchet-phase of the global financial disintegration process, hitting sometime very soon after the New Year. As LaRouche warned in that paper, the heads of state of the major governments of the world—including President Clinton, most emphatically—must follow LaRouche's lead by implementing the New Bretton Woods and Eurasian Land-Bridge policies, or the world plunges, this year, into a New Dark Age.

As for the Brazil IMF package specifically, LaRouche wrote on Oct. 30:

"For Brazil, as was the case for Indonesia, the conditions associated with the IMF's demands, are comparable to, or worse than the effects imposed by the Nazi looting of wartime occupied territories. In none of these cases, such as the recently announced G-7 agreement, have any of the governments duly considered the fact, that what the IMF did to Indonesia, and what the G-7 now proposes for both Russia and Brazil, among other nations, was called 'crimes against humanity' in the post-war Nuremberg Trials of the Nazis."

LaRouche there, as in numerous other writings, singled out the crises in Brazil, Japan, and Russia as among the leading "Achilles' heels" of the world financial system.

In fact, while the eyes of the world were rivetted on Brazil during the second week in January, the Russian time bomb ticked closer and closer to explosion. The government of Prime Minister Yevgeni Primakov has publicly stated that it can only pay $5 billion on its debt for all of 1999. However, the Russian debt obligations for the year, including the Soviet-era debt, is approximately $17.5 billion—three and a half times what the Russians say they will pay.

LaRouche's response to the latest Brazil blow-out was prompt, and unambiguous: "There is only one short-term measure which could bring the chain-reaction factor—capital-flight factor!—under control. That is the immediate institution of capital and exchange controls, followed by steps toward establishing a new monetary order modelled upon the pre-1958 phase of the Bretton Woods system."

Important political forces in Brazil agree with that view of LaRouche's. For example, former Presidential candidate Dr. Enéas Carneiro—who last August hosted a historic visit to Brazil by Helga Zepp-LaRouche, who warned Brazilians about the looming global crisis and what to do about it—has issued an open letter to Gov. Itamar Franco, supporting his debt moratorium action. But Dr. Carneiro went further: Brazil must declare capital and exchange controls and break with the IMF, he argued, and then call on the U.S. government to convoke a conference to establish a New Bretton Woods monetary system (see box).

Meltdown

The events of the second week in January in Brazil were a meltdown waiting to happen, merely triggered by the Minas Gerais debt moratorium. The fragility of the world financial system is revealed in the devastating effect produced by the moratorium on a mere 80 million reals (less than $70 million) in monthly interest payments that Minas Gerais will not be making for the next three months.

President Cardoso has, predictably, tried to blame the entire crisis on one "lone governor." But trying to blame Itamar Franco for the world crisis, wrote one journalist in the daily *O Globo,* is like blaming the Japanese man "who set off a rocket at the same instant that the atomic bomb was exploded over Hiroshima."

What really worries Cardoso—and Brazil's creditors whose interests he has slavishly defended—is that the action taken by Itamar Franco, who was President of Brazil during 1992-94, has *politically* ignited the country. It could trigger similar sovereign measures by a half-dozen other governors (especially those of the opposition parties), and thousands of mayors, all of whom find themselves in equally desperate situations with regard to interest payments on their respective debts to the federal government. The state debts to the federal government, in combination, represent more than $100 billion, which is one-fourth of Brazil's entire public debt.

As a shaken Merrill Lynch broker told the Brazilian press: "What the markets want to know is, how many Itamar Francos are there in Brazil."

In his official announcement of the moratorium, which he proclaimed within days of his inauguration as governor, Franco had stated: "From the moment that we became aware of the chaos that had taken over mainly the financial administration of the state of Minas Gerais, we defined for our secretariat emergency measures of adjustment of public expenditures, and we will not back down from this decision. I therefore reaffirm that Minas Gerais is in a state of moratorium for 90 days, beginning Jan. 1, and that, because of an absolute lack of money, we will not honor financial agreements made by the previous government."

The former head of state added forcefully: "The threats of retaliation by the federal government do not intimidate us, nor do they worry us. . . . If they are concretized, we will know how to act; we will study the available measures to make sure that social chaos, like financial chaos, does not establish itself in Minas."

Days later, speaking to representatives of 26 unions representing public employees, Franco explained his action: "In simple terms, if I borrow 100 reals from a usurer, I owe the usurer. But if my son gets sick, I'm going to spend the 100 reals for my son, and I'll tell the usurer, 'I don't have any money now, you'll have to wait for a bit.' "

Franco's move has begun to catalyze the widespread nationwide discontent against the economic policies of the federal government. Exemplary is the statement of Celio de Castro, mayor of Belo Horizonte, capital of Minas Gerais, who said: "The courageous attitude of Dr. Itamar Franco places him in the leadership of the governors, and also of the mayors." De Castro announced he was going to call a meeting of mayors from throughout the country to be present on Jan. 18, when the meeting of a half-dozen opposition governors was scheduled to be held in the state capital. He also called for the country's mayors to march on the nation's capital Brasilia, on March 31, to force the federal government to renegotiate state and city debts, and warned that a wider moratorium might be declared.

Another signficant statement of support for Itamar Franco came from Ambassador Rubens Ricupero, currently Secretary General of the UN Conference on Trade and Development (UNCTAD), who has criticized the policy of President Cardoso and has called attention to China's successful economic policies, as opposed to the failed system of globalization.

Cardoso's threats are a risky strategy

The knee-jerk reaction by Cardoso, and his international financial controllers, has been to come down like a ton of bricks on Itamar Franco and anyone who supports him. For example, Cardoso's first pronouncement was: "I am the authority of the Republic, who was elected and who obeys the law . . . and who doesn't allow that the law be broken by anyone, no matter who he is. . . . Everyone will obey the law, no matter what it costs."

Similarly, representatives of the world financial oligarchy, such as former Argentine Finance Minister Domingo Cavallo, have demanded an "iron fist" against Itamar Franco. And bankers ranging from BankBoston's President Geraldo Carbone, to officials of Spain's Banco Santander, have issued public warnings that the Brazilian government must not make any concessions to Franco's demands for debt renegotiation.

Franco responded to the Presidential threats: "He should do what he thinks is best, but nobody is obligated to do the impossible." He added: "The emperor has no clothes. . . . What I am doing is defending the interests of Minas. I must first avoid social chaos in Minas. I can't pay the accounts of the state and stop paying the suppliers of food to the state's prisons, the wages of officials and of the military police. This is demanded by the constitution I am sworn to uphold."

But, President Cardoso is bent on playing with fire. Heavy-handed repression against Franco and Minas Gerais,

Dr. Carneiro calls for New Bretton Woods

The following letter was issued on Jan. 14, 1999 by Dr. Enéas Ferreira Carneiro to Brazil's former President Itamar Franco, who is now Governor of the state of Minas Gerais. Dr. Ferreira Carneiro is the national president of the Party for the Rebuilding of the National Order (PRONA), and ran as its Presidential candidate in the 1998 elections. He was one of the individuals who invited Mrs. Helga Zepp-LaRouche to visit Brazil in August 1998, as we reported in our Aug. 28, 1998 issue.

January 14, 1999
Rio de Janeiro
His Excellency Dr. Itamar Franco
Governor of the State of Minas Gerais

The position which Your Excellency has adopted, by deciding to stop, for some time, the payment of interest to the creditors of Minas Gerais reflects, at the very least, a position of absolute and uncontestable *courage*.

This, because Your Excellency made public, without hypocrisy, the impossibility of the State of Minas Gerais to continue feeding the voraciousness of the speculative process which is destroying national life.

We had already warned in an earlier meeting—when Your Excellency served as President of the Republic—of the approaching financial cataclysm, were the interest rates on the payment of the Public Debt to be maintained.

At such a grave and delicate moment for our national life, it is necessary to encourage the movement which Your Excellency began, so that Brazil can, finally, find its way to economic independence and development.

Considering the astronomical level of public indebtedness (on the order of a half-trillion dollars), which monthly drains more than half the National Income in interest payments, with the resulting progressive destruction of national industrial and agricultural activity, we suggest that Brazil, faced with the absolute impossibility of continuing this persistent bleeding of its people, immediately impose a set of measures, consisting of: exchange controls, reducing imports to only the indispensable minimum, a drastic reduction in interest rates, the restoration of credit—for *national* productive activity—through the Banco do Brasil, and freezing for some time, *along the lines of Your Excellency's fearless example,* any cash payments to the creditors of our Internal and Foreign Debts.

In the state of already unsustainable crisis in which the country finds itself, it is inconceivable to take on loans from the IMF or similar institutions. This is not the solution to our problem. It is the cause of it. It is time that we rely on our own resources.

It is of fundamental importance that Brazil, shielded by its unique geopolitical situation—a gigantic territory, unimaginable wealth of raw materials, energy and agricultural potential, a world leader in potable water—direct an explicit call to the United States of America for that country to convoke, under its leadership, a new Bretton Woods agreement in which sane regulations are defined for the existence and functioning of the International Financial System, putting an end to the current speculative process which, like an insatiable cancer, is eating away at the insides of sovereign Nation-States, decimating their populations.

The participants in this Emergency Meeting should include the great world powers which have, in one form or another, opposed the current dictates of the International Financial System. I refer to China, India, Russia, and our Brazil.

Your Excellency has sparked a process which has every possibility of becoming irreversible. Reason and a minimum of civic spirit aimed at national salvation, point to the adoption of the measures I have suggested.

Anything other than this, maintaining the status quo, would mean plunging into a New Dark Age, the first signs of which already appear on the horizon.

Sincerely,
Dr. Enéas Ferreira Carneiro
National President of PRONA
Former Presidential candidate

is likely to only set off a social explosion around the country, and would unleash a major constitutional crisis as well, which has long been brewing.

The issue resides in the fact that Brazil is governed by a *federated* system—that is, the states are federated into a national union, but historically have retained important economic and political power. No federal government in the 100-year republican history of Brazil has been able to challenge that arrangement . . . and survive.

In today's crisis, that translates into the fact that the economic policy dictated to Brazil by the IMF and World Bank, and blindly carried out by the Cardoso government, deliberately demands the concentration of a tyrannical centralized economic power within the federal government, while destroying the capacity of the states to administer their own economies. In fact, the recent reorganization of the states' debts was done with this in mind, and as a result the states have been asphyxiated by interest payments and forced to privatize and otherwise dismantle nearly all of the state and municipal companies, including their traditional banking and credit systems.

This whole process, if allowed to continue, will culminate in the destruction of the Brazilian federated system, followed by the establishment of a British colonial-style currency board. That would put an end to the country's monetary and credit-generating sovereignty, and turn it into a colony of the world financial oligarchy.

If Franco sticks to his guns and succeeds in unifying a patriotic insurgency in defense of the country's sovereign development, Cardoso and the IMF will be in a bind. The only road that would then be open to them, would be to undertake a federal intervention against the states, which would require the backing of the Brazilian Armed Forces. But there is also substantial ferment within the military against Cardoso's policies of handing sovereignty over to foreign financial interests, and there is no guarantee that they would carry out such a mission.

As one experienced Brazilian politician, a former cabinet minister, told this magazine: "Since the period of the [Portuguese] Empire, there has never been a government that can sustain itself against the opposition of Minas Gerais, São Paulo, and Rio de Janeiro. Remember that the 1930 Revolution involved the states of Rio Grande do Sul and Minas Gerais, which overturned the Old Republic."