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The IMF's Coming Brazilian Waterloo

by Dennis Small

What will the government of Luiz Inácio "Lula" da Silva do, when he assumes the Presidency of Brazil on Jan. 1, 2003? That is one of the hottest questions among international financial circles, given the fact that Brazil has the largest foreign debt—more than $500 billion—of any nation in the world, and that it has been teetering at the cliff-edge of default for months. Brazil is also the preponderant nation, economically and politically, in the highly volatile region of Ibero-America: Where it goes, the entire continent will soon follow. And the fate of the International Monetary Fund also hangs in the balance. A Brazilian default could bring down the entire U.S. banking system, and the IMF with it.

Much nonsense has been pronounced on the subject of the incoming Lula Presidency. For example, there are those who assert that Lula is pretty much the Devil himself. That is the line of people like Constantine Menges, the Hudson Institute windbag who shares the pro-war policies—and the ties to the pornographic Moon sect—of the Utopian faction in the Bush government. Menges insists that Lula is going to develop nuclear weapons and the missiles to deliver them; that he will establish a terrorist "axis of evil" on the continent with Cuba's Fidel Castro, Venezuela's Hugo Chávez, and the Colombian FARC (Revolutionary Armed Forces of Colombia); and that he intends to bring down the entire "free market capitalist system."

On the other hand, there are those who argue that Lula is in Wall Street's hip pocket, and that he will do exactly as the International Monetary Fund (IMF) tells him. The Brazilian debt is *not* out of control, they insist, and the country will *not* default on its obligations. That is the line being peddled by the influential New York Council on Foreign Relations (CFR), through its British Brazilianist Kenneth Maxwell.

Neither of these two views is correct.

In a Nov. 19 interview with the Mexican daily *Excélsior,* U.S. Presidential pre-candidate Lyndon LaRouche explained the actual situation facing Lula and Brazil:

"If Brazil is forced to submit to currently proposed types of conditions, the resulting collapse of Brazil will set off an immediate chain-reaction, blowing out not only the U.S. banking system, but also the IMF system. If Brazil is permitted conditions under which it could survive, that would also blow out the U.S. banking system and, therefore, the IMF, too. The only solution, therefore, is a general reform in bankruptcy-reorganization of the U.S. Federal Reserve System, and a reorganization-in-bankruptcy of the IMF by concerted emergency action of the most relevant sovereign nation-states whose property the IMF is.

"This puts Lula in an interesting situation, whether he wished it, or not."

Lula has not defined which way he will go, as the financial house of cards comes tumbling down. In fact, he probably doesn't know himself what he is going to do. For the time being, Lula and his top advisers have issued repeated reassurances to the international financial community that Brazil will continue to honor all its debt obligations (which is a physical impossibility), while at the same time reaffirming their intention to improve the Brazilian population's lot, reduce hunger, lower interest rates, and so on.

Thus, Lula has been referred to, by some, as the "Sandwich President"—caught between massive pressure from the international financial community, and the overwhelming rejection of just such IMF policies by the Brazilian population.

The October elections in Brazil were a reflection of that popular dislike for globalization and the IMF. Lula's victory

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was one expression of that phenomenon; another was the unprecedented vote totals received by Dr. Enéas Carneiro in the federal congressional race. But what has really unleashed panic in the international financial oligarchy, is the direct involvement of Lyndon LaRouche and his economic proposals in both of these processes. This factor was visibly expressed in the U.S. Presidential pre-candidate's high-profile visit to Brazil in June of this year. It is this LaRouche factor, in the view of international oligarchy, which can be the straw which breaks the camel's back.

Thus, the grave death threats issued against Dr. Enéas and his colleagues in the PRONA party (see *EIR,* Nov. 29). And thus the pathetic attempts by the CFR's Kenneth Maxwell, and others, to try to discredit LaRouche in Brazilian eyes by lyingly linking him to Menges' Moonatic outbursts.

Whatever policy Brazilian President-elect Luiz Inácio "Lula" da Silva adopts with respect to the physically unpayable $500 billion foreign debt, the International Monetary Fund system is finished.

Wall Street's Charm Offensive

Maxwell's argumentation is most revealing. In an article in the Dec. 5 issue of the *New York Review of Books,* Maxwell, who heads up the Council of Foreign Relations' Latin American Program, fervently insists that the United States can, and must work with Lula, because he can be roped into staying with the system. Those who argue that the "red tide" swept Brazil in this election are wrong—just as it is, also, "an exaggeration to call this vote a rejection of the Washington Consensus and neo-liberalism," Maxwell asserts wishfully. Maxwell goes so far in his promotion of Lula, that he compares him to "another ex-union man" of simple tastes with popular ties, elected with a huge number of votes: Ronald Reagan!

Maxwell explicitly savages the idiotic line coming from the Moonie nut, Constantine Menges, that Lula's election as President brings to power the São Paulo Forum and sets up a new "axis of evil" in the hemisphere among Fidel Castro, Hugo Chávez, and Lula.

At this point, Maxwell attempts to drag Lyndon LaRouche into Menges' Moonatic campaign. No one in Brazil even knew of what the São Paulo Forum was, Maxwell claims, but when he went to track back "the origins of this anti-Lula campaign, I find it begins with no less an 'authority' than Lyndon LaRouche, whose webpage asserts: 'The São Paulo Forum has very high-level sponsors inside the financial and political establishment of the Americas, in the form of a Washington-based think-tank founded in 1982 by David Rockefeller, McGeorge Bundy, and others, known as the Inter-American Dialogue.' "

The Maxwell/CFR article was, de facto, a major policy statement coming from the very heart of the Anglo-American Establishment. Its nervous point can be roughly paraphrased as follows:

Things are *not* in control in Brazil. This is no time to push Lula up against the wall, as the Menges Moonatics propose, because that might well backfire and drive the country into the LaRouche policy approach. We have to make nice to Brazil for the moment, as we deploy to get things back under political control. Don't call in the debt, for now; keep throwing money at the problem—just as U.S. Federal Reserve Chairman Alan Greenspan and others have argued must be done globally.

Just as Maxwell recommended, Wall Street is on a charm offensive. On Nov. 19, the IMF team down in Brazil for its quarterly review, came out of its meeting with Lula's representatives, telling the press, "We are very happy." From Washington, IMF spokesman Francisco Baker told reporters on Nov. 22 that the IMF's "impression is the program is excellent," and the new government is planning measures which are "prudent and appropriate." The disbursement of the next $3 billion loan installment of the $30 billion package is considered a given now. The IMF accepted the request from Lula's team that discussion of any increase in the primary budget surplus the Brazilian government must generate be put off until the next scheduled review, in February. Likewise, the IMF team had tried to find out how the incoming government would pay for its planned increases in expenditures on social spending, and was not satisfied with the answers it got, but decided that could wait until February, too.

Similarly, during a Nov. 19 panel at a summit sponsored by the World Economic Forum (Davos Forum) in Rio de Janeiro, top honchos from a half-dozen New York investment houses and banks spoke of the great prospects for Brazil under the incoming Lula government. "Lula will surprise the market when it adopts more austere economic measures, favorable to the market," said Gray Newman, Morgan Stanley's chief economist for Latin America. ABN Amro's Arturo Porzecanski stated uncharacteristically: "I also think that Brazil will surprise all of us with reasonable political actions on the part of the new government." And Geoffrey Dennis, chief stock market strategist for Latin America of Salomon Smith Barney, went so far as to pronounce: "We now recommend Brazil in a fairly aggressive way to our investors."

These are the very banking houses and individuals who, a few short months back, were screaming that the election of Lula would be the end of the world, that a Brazilian debt default was virtually inevitable, and that they were therefore refusing to roll over maturing Brazilian government bonds at interest rates lower than 50%.

Not to be outdone, the Bush Administration had at least three top officials down in Brazil in mid-November to woo the new government. Assistant Secretary of State Otto Reich, a Lula-basher only weeks before, announced that "we will do everything within our reach to help Brazil. The struggle against hunger is an essential element for development. . . . Lula is a man who believes in democracy." Deputy Trade Representative Peter Allgeier also pronounced his favorable evaluation. And Deputy U.S. Treasury Secretary Kenneth Dam gilded the lily on Nov. 22, after meeting with Senator-elect Aloizio Mercandante, a top Lula adviser: "I don't think there is anything that's happening now in Brazil that's cause for concern. We're quite pleased with the statements and signals that have been sent by the incoming administration."

All of this led one Brazilian diplomat to pointedly comment to the *Financial Times* of London: "We haven't seen this kind of attention in a while."

Default Looms

Brazil is no less insolvent today than it was before the Maxwell signal piece was written. The public debt now stands at about $300 billion, and rising. About 45% of this total is held in dollar-denominated bonds, which means that every devaluation of the Brazilian currency, the real, vis-à-vis the dollar automatically raises the debt owed. The real continues to float at less than 3.5 reals to the dollar, and a renewed speculative assault on the currency looms at any moment.

Another 43%, minimum, of the government bonds is indexed to floating market interest rates, which similarly causes the debt to grow "spontaneously" with every jump in interest rates. On Nov. 20, the Brazilian Central Bank raised the benchmark interest rate from 21% to 22%, and further rises are only a blink away.

As recently as September, Wall Street analysts had candidly calculated that the Brazilian public debt bubble could not be kept afloat unless interest rates dropped to under 10%, and the value of the real rose to 2.5 to the dollar. Since neither of these conditions is remotely possible in the real world, they confessed, Wall Street should brace itself for an unavoidable Brazilian blowout.

If anything, the numbers today are worse than they were in September.

As noted, neither President-elect Lula nor his team has actually announced any substantative policy yet. The Cabinet has not been named, as Wall Street demanded. The only concrete step taken on this front, in fact, is, that Lula has reiterated that he will *not* keep Arminio Fraga on as Central Bank president for the transition, as Wall Street desires.

One interesting policy option was floated by Senator Mercadente, who told reporters in Brasilia on Nov. 20 that Lula will visit Argentina on Dec. 2, and will propose that Argentina and Brazil create a common currency for trade. Mercadente stressed that "Argentina is really a strategic partner," and that the new government proposes that the two partners increase their trade and cheapen the cost of food in both countries, by establishing a "green currency." The idea, Mercadente elaborated, would be to use the common currency as a unit of accounting, with any trade imbalances between the two nations settled periodically by the central banks, in dollars.

Why call it the "green" currency? "We call it 'green' because at the beginning it would be used exclusively for agricultural trade," Mercadante explained, but it could become the embryo of a future common currency, generally. "The idea is that trade be carried out without necessity of using foreign currencies. Put another way, a single market would be formed between Brazil and Argentina where the producers of each country would operate as locals. The Argentine producer receives pesos, in their 'green money' equivalent, for their sales in Brazil. In the same way, the Brazilian receives reals for his sales in Argentina. Under this plan, who pays the exporters are the central banks of each country, and in local currency."

Both countries face financing problems for anything in dollars, because of the cut-backs in their credit lines, but this way agricultural trade would be carried out without the necessity of using any foreign exchange. This could not only increase trade, but cheapen the cost of food, while increasing its supply, he argued.

Although the critical issue of how to set a *fixed* exchange rate between the real and the peso, on the one hand, and the new green currency, on the other, is not addressed—along with the related issue of making the new currency *inconvertible with the dollar speculative bubble*—the proposal otherwise has many intriguing elements in common with LaRouche's policy calling for nations and regional blocs to engage in "trade without currency," as a stepping stone toward a fully elaborated New Bretton Woods system.