BRAZIL'S DEBT CRISIS: THE BLAME IS WIDELY SHARED

For the second time in four years, Brazil has unilaterally told its foreign creditors that it will not pay interest on its debts. As Brazil is the largest of all Third World debtors, with outstanding loans of $108 billion, this understandably has shocked the international financial markets. What is more shocking is that the world's leading capital management agencies, such as the World Bank, International Monetary Fund, U.S. Federal Reserve System, and the U.S. Treasury, have contributed to Brazil's economic difficulties. For years, these institutions have designed, approved, and supervised numerous financial aid and policy reform packages for Brazil--and other Third World states--ostensibly to achieve self-sustaining growth. Instead, these efforts have, in many cases, extended harmful public sector control over economic affairs.

Only months ago Brazil was hailed as the model for Third World economic performance and debt management. In reality, however, the Brazilian government in the past year has been manipulating its economy for political reasons. Just prior to the November 1986 elections, for example, massive stimulus was applied to induce short-term growth. The current economic collapse followed. After this, the IMF, U.S. Treasury, and others were forced to give their grudging stamp of approval to Brazil's supposedly revised policies in order to keep foreign loans forthcoming. Indeed, the IMF sent a formal letter last December to Brazil's foreign government creditors validating the nation's most recent economic plan. That Brazil is again on the brink of default attests not only to its own internal mismanagement, but also to the hollow rhetoric and failed missions of leading international financial institutions.

What went wrong in Brazil? In February 1986, the new civilian government launched the Cruzado Plan, ostensibly to deal with 400 percent inflation. Prices were frozen while the indexation of wages to inflation was curtailed. This plan was meant to promote economic growth and to avoid IMF austerity measures. Fiscal and monetary rationality, however, were ignored.

During 1986, the budget deficit continued to grow and the monetary base rose by over 200 percent between March and the November parliamentary elections. Increased wages under a price freeze caused consumption to explode. Goods usually exported were drawn into the domestic market, swiftly eroding Brazil's trade surplus. Then when price controls were eased in late November, inflation soared to 800 percent.

To make matters worse, the government of President Sarney has failed to cut back Brazil's massive public sector. Government spending totals half of Brazil's annual gross domestic product. Some 80 percent of the external debt is owned by the public sector, and 60 percent is accounted for by state enterprises, many of which are funded by the World Bank and the Inter-American Development Bank.

Contributing significantly to Brazil's problem has been the ease with which foreign politicians obtain international loans and then misuse them. Many of the proceeds have gone into inefficient state-owned enterprises. Example: the World Bank approved a $400 million loan in FY 1985 for the recapitalization of Brazil's bankrupt state power companies. Other foreign loans have disappeared through corruption, graft and capital flight.

Official loans supposedly were made conditional on proper policy reforms to ensure sustained economic growth. Brazil's financial predicament attests that such conditionality has failed.

What can be done? First, U.S. banks should make arrangements to write off existing loan mistakes in an orderly manner over a number of years. This will avoid disruptions and insolvencies in the U.S. banking system. Second, Third World political leaders and governments should not be let off the hook too easily for past spending indiscretions. Very few of these debtor nations are insolvent; they just do not want to use their substantial resources to honor their debts. Third, the international financial ponzi scheme that allows for repayment of loans only if new lending exceeds the current installments due must end. Finally, a hard reevaluation is long overdue of the political and financial institutions whose leaders helped create Brazil's problem and those of other Third World debtors. Decades of evidence reveals the harm caused by artificially skewing capital flows toward Third World governments. Yet such lending persists and expands, spurred by such official institutions as the U.S. Treasury. Politics, not markets, still directs far too much international lending. Until these fundamental flaws are corrected and more reliance is given to market forces to produce growth, there will be more Brazils and more severe debt moritoria and crises.

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