No. 569

February 4, 1999

THE IMF STRIKES OUT ON BRAZIL

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The financial crisis that crippled Brazil in January despite a preemptive international bailout last November further discredits the lending policies of the U.S. Department of the Treasury and the International Monetary Fund (IMF)—policies supporters claimed would solve the global financial crisis. Brazil's inability to avoid devaluating its currency on January 13 confirms lessons the global community should have learned in Asia and Russia last year: The IMF's lending policies harm, rather than help, economies; keep them from instituting sound financial policies on their own; and undermine support for free trade. Instead of continuing support for IMF bailout packages, the Clinton Administration should pursue solutions that specifically address the financial problems in each country.

A Record of Failure. Following the Asian financial crisis that began in Thailand in July 1997, the IMF orchestrated a succession of bailouts—with President Bill Clinton's enthusiastic support—that totaled over $175 billion in emergency loans to Thailand, South Korea, Indonesia, Russia, and Brazil. U.S. taxpayers underwrote these loans with tens of billions of dollars. The IMF and the Clinton Administration argued that these packages would strengthen the economies of the afflicted countries, prevent their citizens from suffering undue economic hardship, and prevent the spread of the financial crisis to other countries.

The IMF and the Administration were wrong on all counts, however. The global financial crisis continued to expand following the bailouts, undermining world trade and economic growth. Every country under the IMF's financial "guidance" suffered severe economic contraction and plunged hundreds of millions of people back into poverty in a domino effect that threatens economic growth even in the United States.

The IMF's latest victim is Brazil. After the successive failures of IMF loans to arrest financial crises in Asia and Russia, President Clinton proposed in October 1998 the creation of a "new mechanism" to prevent future crises. This new IMF mechanism is to provide billions of dollars in loans to a troubled country *before* the onset of a crisis. This mechanism represents a significant departure from previous policy because no evidence of a crisis would need to be demonstrated in order to obtain IMF loans; merely the possibility of a crisis would be sufficient.

Produced by
The Kathryn
and Shelby Cullom Davis
International Studies Center

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

Brazil is Latin America's largest economy and the eighth largest in the world. It became the first beneficiary of the new mechanism in a $41.5 billion rescue package in November. According to U.S. Secretary of the Treasury Robert Rubin, the package would "guard against financial market contagion" by convincing investors Brazil had more than enough resources to defend its currency—the *real* —indefinitely. In return, Brazil's government, under

President Fernando Henrique Cardoso, agreed to enact a three-year, $84 billion austerity program that included tax increases, government spending cuts, and a firm commitment to preserve the stability of the *real*.

The new preventive package for Brazil failed to "prevent" a crisis. After receiving over $9 billion of the $41.5 billion, Brazil announced on January 13, 1999, that it would allow the *real* to trade within a larger band (representing, effectively, a devaluation). On January 15, Brazil abandoned all pretense of supporting the *real* and allowed the currency to float. During January, the *real* lost more than 40 percent of its value against the U.S. dollar, and investors took more than $8 billion out of the country. This failure occurred for several reasons:

- The initial $9 billion IMF disbursement alleviated the urgency in Brazil to enact reforms.
- Brazil's National Congress and state governors enjoy an extraordinary degree of autonomy in dispensing patronage and contracting debt. President Cardoso's promised reforms attacked this system of constitutionally protected political patronage and privilege.
- Faced with strong political opposition and an IMF package that made his reforms appear less urgent, President Cardoso failed to exercise leadership and force his reforms through an unwilling legislature.
- When Governor Itamar Franco of Minas Gerais declared a 90-day moratorium on paying his state's $15.4 billion debt in early January, investors quickly lost confidence in Brazil's ability to meet its obligations.

In the wake of the *real*'s collapse, Brazil's government is rushing to enact the reforms President Cardoso pledged nearly three months ago. Both houses of the National Congress passed a bill to reform the social security and pension fund systems for public workers, which together account for about half of the government's $64 billion budget deficit (over 8 percent of gross domestic product). Cardoso also proffered to the state governors a plan to restructure their debts—estimated to be more than $85 billion of the $270 billion in total domestic debt—to the federal government if they agreed to downsize their bureaucracies, cut spending, and privatize water and sewage services. Most state governments are controlled by opposition political parties, however, and they do not appear disposed to accept fiscal reforms that threaten their clout.

Implications for the Two Americas. The crisis in Brazil will hurt the United States, too. More than 2,000 U.S. multinational corporations conduct business in Brazil, with combined direct investment totaling over $30 billion; U.S. banks have some $28 billion at risk. Although Brazil accounts for only 3 percent of total U.S. exports ($16 billion in 1998), over 200,000 jobs inside the United States are at stake. The impact on the United States will worsen if the Brazilian crisis ripples across Latin America. The region's economic growth—forecast at less than 2 percent for 1999—is likely to slow even further. Other countries may devalue their currencies to compete with exports from Brazil. Interest rates, unemployment, and poverty are likely to rise in the region this year, leading many Latin Americans to question the free-market policies that have been blamed—incorrectly—for the crisis.

Conclusion. The record shows that IMF lending practices impose undue hardships on consumers and workers in developing countries. They destroy developing economies, waste U.S. tax dollars, and hurt the economic and security interests of the United States. Instead of relying on an IMF bureaucracy that lacks transparency and accountability, the Administration should restore the primacy of free trade in U.S. foreign policy: It should reinvigorate the effort to create a Free Trade Area of the Americas in Latin America and promote currency stability through currency boards or adoption of the U.S. dollar. This would lower the risk of financial crises in the future and mitigate the severity of any such crises that may occur; it also would promote economic growth throughout the hemisphere.

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