EIR Economics

Ecuador defaults on debt; other nations to follow

by Valerie Rush and Marcia Merry Baker

On Aug. 25, President Jamil Mahuad of Ecuador announced that a payment of $96 million due Aug. 31—or no later than Sept. 30—on its $6 billion in so-called Brady bonds, cannot be paid. There are 18 countries that have issued a total of about $200 billion of such restructured Brady bond debt, since the time these bonds were devised ten years ago.

Brady bonds are defaulted sovereign country debt, repackaged so they can be resold, with most including U.S. Treasuries as partial collateral. The Bradies, in other words, were supposed to be the "answer" to unpayable debt!

But now, with the world economy in a tailspin, for lack of measures to restore a functioning international financial system serving national economies, it was inevitable that the "Brady" category of debt, like other pyramided categories of debt, would, at some point, become unsupportable. That time is now, and Ecuador is the first nation among the Brady debtors to declare this.

President Mahuad, on announcing the debt payment deferral, was quick to give assurances that his country would work things out with the International Monetary Fund—a bit like Little Red Riding Hood negotiating with the wolf. Mahuad said, "Ecuador is the first country in the world that is doing this. It's the first country that proposes a restructuring of its debt with international help." And, he claimed that the IMF and other international lenders accept the plan. "We're going to tell them this is a serious country, which acts in good faith, which wants to meet its international commitments, but has problems paying, and that as creditors, they should permit us to make payments under conditions that are adaptable and applicable to the size and reality of our country," he said in his speech.

Ironically, President Mahuad spoke on the eve of the anniversary celebration of Malaysia's Sept. 1, 1998 initiative to take financial and economic national-interest measures *to prevent* IMF-sanctioned depredations against the country (see article in this section).

Chain-reaction effects

As of the first of September, chain-reaction effects of the Ecuador announcement—minuscule though the default may be in itself—were already blowing back through the world financial system, most directly through the derivatives bubble. In addition to Ecuador, other government and corporate debt defaults or near-defaults were announced, from South Korea, to Ukraine and Russia, as well as elsewhere in South America.

As a direct consequence of Ecuador's situation, financial sources reported on Sept. 1 that Merrill Lynch was forced to redeem $86.5 million in credit-derivatives linked to Ecuador's Past Due Interest (PDI) Bradies, after the derivatives lost almost all value when the PDIs upon which they were based lost more than 33% of their value the last week in August. That triggered "call" provisions in contracts.

The world market in credit derivatives is estimated at around $400 billion, and Ecuador's default can trigger calls on other such Ecuador-linked derivatives, and knock the props out of contracts holding up the derivatives bubble. Lawsuits, such as erupted after the Russian default in August 1998, are now to be expected. The wrangling point will be whether this was a "true" default or not, according to the criteria in definitions of credit derivative contracts. Among those selling such instruments are Crédit Suisse-First Boston, Morgan Stanley Dean Witter & Co., HSBC, and Trinkaus.

Mad scrambles are under way in the City of London and on Wall Street, to try to contain the impact. On Aug. 27, a paper, "Ecuador: Implications of Default on Its Brady

Bonds," written by George Folsom, was put out by the Forum for International Policy. This Washington, D.C.-based outfit is chaired by former National Security Adviser Brent Scowcroft, and its board includes prominent Bush politicos. (See article in the *National* section.)

'Skillful debt management' flops

The Brady bonds were the means by which the bankrupt world financial system was bailed out in 1989, forcing bankers to accept a write-down of the value of their debts, in order to save the system. The architect of this scheme was not George Bush's Treasury Secretary Nicholas Brady, after whom they are named, but his Deputy Secretary, Crédit Suisse-First Boston's David Mulford, the mentor of the leading Ibero-American finance ministers of the 1990s, Mexico's Pedro Aspe and Argentina's Domingo Cavallo. Mexico, Argentina, and Venezuela are among the biggest Brady bond debtor nations.

The express concern of the Brady bond advocates today, as stated in the Folsom brief, is that somehow, Ecuador's default must be "skillfully managed" in a way to prevent the entire global Brady "asset category" from going down the drain, along with Ecuador. By the calculation of the Forum for International Policy, Brady bonds made up fully 37% of the turnover in the $4.2 trillion trade in all types of "emerging market" debt instruments in 1998.

As of Aug. 30, Brazil is paying 20.73% interest on its Brady par bonds, and Argentina, 15.66%. These rates are impossible to honor. Local, state, and national governments are announcing pending or certain defaults, whether or not Brady bonds are involved.

The crisis spreads

In Russia, the region of Nizhni Novgorod, the third largest in the nation, has requested a meeting with bondholders for Sept. 22, to reschedule payments on its outstanding international bonds. This crisis portends default by other Russian regions, including the City of Moscow. To avoid a technical default, Nizhni Novgorod may ask for a two-month delay. At present, the Nizhni Novgorod bond is trading at less than 25% of its nominal value.

Ukrainian President Leonid Kuchma said on Aug. 30, on a campaign swing to the Crimean Peninsula, that money "cannot be found in our budget" for upcoming total government debt payments scheduled ahead for $3.5 billion due next year, about double the amount due this year. Kuchma added an election-pitch to his we-can't-pay announcement, saying that if he is re-elected this Oct. 31, foreign creditors would help negotiate a restructuring of this debt, because of their confidence in him. He had better look again; confidence isn't worth anything anymore.

In East Asia, there is a tidal wave of corporate and banking crises. South Korea's largest conglomerate, Hyundai, is now following after Daewoo in financial trouble. In early September, Daewoo warned that it may not be able to pay foreign creditors the $7.7 billion owing. Hyundai was informed by foreign creditors that it has six months to rearrange its debt, or else credit lines will be cut. On Sept. 1, the Seoul government's Financial Supervisory Committee announced that it is preparing to declare Seoulbank insolvent, and begin takeover arrangements.

In Thailand, the leading banks recorded huge losses for the first half of 1999, led by Krung Thai Bank, the Finance Ministry-run institution which was used to take over nonperforming loans of the commercial banks.

In Brazil, Gov. Anthony Garotinho, of Rio de Janeiro, the third-largest state, said that they do not have the means to pay debts owing the federal government due Sept. 30. "The government is driving us toward a moratorium," he told the daily *O Globo,* in an interview in late August. In turn, without payment from Rio, the federal government will not be able to meet the conditionalities linked to the last IMF $41.5 billion "rescue" package.

The total debt the Brazilian federal government, the states, and the municipalities owe private and public banks and international institutions, hit 491 billion reals (Brazil's currency) at the end of May, up by 8 billion reals in May alone. That equals 49.8% of Brazil's GDP! The federal government and state companies owe 68.8% of the total; the states, another 27%; the towns, 4%.

Brazil has been paying against this impossible debt load, by shorting its population. According to a report by the Institute of Socio-Economic Studies, in the first half of the year, the federal government paid out 56.94% of the total 28.57 billion reals budgeted for debt payments in 1999, but only paid out 8.45% of the measly 8.73 billion reals which they had budgeted for investments in social services.

Revolts, mass strikes

Although Ecuador's finance experts were scurrying around Washington in early September, claiming to have come up with a deal with the IMF that will enable them to meet the Sept. 30 "last chance" payment deadline, there is one reality factor that cannot be ignored: A revolt in Ecuador against IMF austerity conditionalities is growing, and will likely paralyze or even collapse the government, before it ever gets the chance to implement its new deal. A series of nationwide strikes, begun back in March when President Mahuad attempted the first twist of the IMF tourniquet, has repeatedly forced the government to retreat, while the Congress has refused to rubber-stamp the IMF's demands.

The Ecuador stand-off takes place in the context of a mass-strike process now ongoing in several other Ibero-American countries, notably Brazil and Colombia. On Aug. 27, an estimated 100,000 Brazilians poured into the streets of the capital, Brasilia, to protest President Fernando Enrique Cardoso's IMF-modeled economic policies. Some sectors were calling for Cardoso's ouster, as well. One day earlier, 30,000 debt-burdened farmers had marched on the capital, to demand a turnaround in the government's murderous agricultural policies. Cardoso's blind response was to complain that the protests are part of a conspiracy to overthrow his government. The unions answered with threats of a general strike in September, if the government continues its refusal to listen to them.

Where the crisis could rapidly lead, is best seen in Colombia, whose leadership has in effect abandoned the helm to the narco-terrorist FARC guerrillas. Colombians today are suffering an official 20% unemployment rate, a bankrupt financial system, plummeting industrial production, and an agricultural sector ravaged equally by narco-terror and a flood of cheap imports. The population, fed up with the policies of President Andrés Pastrana, is demanding a complete turnaround in economic policy, and in particular is rejecting Pastrana's would-be submission to the IMF for a promised $3 billion bailout.

However, poised to capitalize on this popular anger is the FARC, whose drive for power—Pastrana's fantasy about a peace parley notwithstanding—has never been stronger. The country was virtually shut down on Aug. 31, by a "civic strike" called by the leading labor federations, in combination with peasant organizations. Behind the scenes, but fully prepared to take over the action, are the FARC's 15-20,000 heavily armed terrorists.

Then, just across the border, the Venezuelan Presidency of Hugo Chávez is organizing a Jacobin movement which, in coordination with Colombia's FARC and other terrorist and pro-terrorist movements in other countries, could set the entire continent aflame, while diverting legitimate outrage over IMF looting into outright chaos.

Already, the Chávez dictatorship has shut down the Supreme Court and Congress, replacing them with a "people's assembly." The strategically key national oil company, PDVSA, is being purged, and its director has been replaced by a Chávez loyalist. While Hugo "Robespierre" Chávez screams at every opportunity about cleaning out corruption, his minions are organizing lynch mobs. Federal District Mayor Hernán Gruber, a leading member of the Chávez team, has issued a call for public executions in the plazas of Venezuela, while the governor of the state of Lara, Orlando Fernández, instructed district police to refrain from acting to save "criminals" from lynching. The day after Gruber's calls, someone was lynched in the state of Falcón.

As Chávez proclaimed on Aug. 29: "Order has arrived in Venezuela."

How can we escape a Dark Age?

In the face of this global picture of crisis, Lyndon LaRouche has offered policies that, even at this late date, could turn the situation around. In a speech on July 24 at the Schiller Institute summer academy in Oberwesel, Germany (published in *EIR* on Aug. 6), LaRouche summed up the situation this way:

"So, this is the greatest, most terrible time in all known modern history. No part of modern history is more dangerous, more catastrophic than the moments we're living through now. Oh, you may not see or feel that there's a crisis out there. But, let me tell you what's going on, so that you can feel it, right now.

"You'll get a crash soon enough. A crash worldwide, which will remind you, if you study it, of what happened in Germany in 1923, in the fall of 1923. That's happening. That's going to happen. But, in the meantime, you have another form of crash, something just as bad as a crash: Were any of you ever in an earthquake? Were you ever standing where an earthquake was happening? You thought you were standing on solid ground, and suddenly you weren't certain which way was up, and where the ground was going. The ground began to feel something like quicksand. That's what's happening now. You're in that phase of an earthquake where the first shocks are coming through, and the ground under you, the social ground, the political ground is turning to something like quicksand. It's a warning: The big one is on the way.

"But, we can be optimistic, because we have to recognize that when things are this bad, we've destroyed the illusions of people. And when their illusions are destroyed, you must quickly organize them around a well-founded program of hope."