CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

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PRESS RELEASE

For Immediate Release
November 13, 1998

Press Release #105-195
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IMF BRAZIL LOAN TRIGGERED BY RUSSIAN FAILURE

WASHINGTON, D.C. — The $41 billion Brazilian loan package orchestrated by the International Monetary Fund (IMF) continues the recent trend of large bailouts with attendant moral hazard problems, **Joint Economic Committee (JEC) Chairman Jim Saxton (R-N.J.)** said today. Saxton expressed concerns the tax increases and other conditions imposed in Brazil may have a counterproductive effect on its economy as well as the economies of surrounding nations. The IMF loan terms partially comply with recent congressionally mandated IMF reforms, but do not appear to set market rates reflecting true borrower risk.

"We must remember the road to this Brazilian loan was paved by the dismal results of the IMF/U.S. Treasury strategy in Russia," Saxton said. "The failure of the IMF's policy in Russia triggered world financial instability, with very negative consequences for Brazil and several of its neighbors. Fortunately, at least the IMF did not implement the Treasury's ill-conceived preemptive bailout proposal in structuring this Brazil loan."

With respect to a large proportion of the IMF loan, the IMF interest rate is not as deeply subsidized as IMF rates typically are, though this interest rate does not fully reflect market interest rates adjusted for risk, as called for by congressional reforms. The standard IMF loan rate of 4 percent represents a deep subsidy on part of the Brazilian loan. Thus, the loan to Brazil as a whole is still highly subsidized and the associated interest rates do not reflect an adjustment for risk that would raise them to market levels. Consequently, the limitation of moral hazard that would follow the use of market rates is greatly undermined.

"Furthermore, the conditions imposed by the IMF on Brazil may prove counterproductive and slow the economy, worsening the financial situation," Saxton said. "The standard tax increase recipe favored by the IMF will not only harm the Brazilian economy, but also hurt the middle class, just as it had in Mexico, Korea, Indonesia and elsewhere."

The use of the Exchange Stabilization Fund (ESF) to cover $5 billion of the package shows how far the ESF has come from its original purpose. A recent JEC study suggested consideration of abolishing the ESF in a move to clarify our nation's international economic policy.

"A clarification of international economic policy is certainly in order," Saxton said. "As I pointed out six weeks ago, interest rate cuts by the Federal Reserve and reform of the IMF and ESF would be very positive steps. Since then, the Federal Reserve's actions to cut interest rates has averted fears of potential deflation, which has calmed financial markets, but the assurances of comprehensive IMF reform have not been pursued. This Brazilian package, as well as the IMF's recent overtures to Iraq, demonstrate that IMF reform still has a long way to go."

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