

# Central Banker ‘Chico’ Lopes falls in Brazil; will others follow?

by Lorenzo Carrasco and Gretchen Small

The refusal of former Brazilian Central Bank president Francisco “Chico” Lopes to testify before the Parliamentary Commission of Inquiry of the Federal Senate, which is investigating crimes against the national financial system, was a desperate measure of self-defense. This Harvard-trained blueblood banker evidently has no interest in going to jail for committing fraud and illegal trafficking with insider information, during the few weeks he was head of the Central Bank in January of this year.

It is widely reported that Lopes refused to testify on the advice of his lawyers, who believe that he stands a better chance of “resolving” his case in the criminal courts, rather than in the political court, i.e., Congress.

Although Lopes was hauled off to jail while the television cameras whirred, he was released on \$175 bond five hours later. He flew home from Brasilia to Rio de Janeiro, to find that the Parliamentary Commission of Inquiry has frozen his personal assets and ordered an investigation into his telephone and banking records.

But, Lopes’s personal problems are small, compared to the hot political situation his legal maneuver has created for the government, which had hoped to contain the Parliamentary Commission of Inquiry’s investigation by sacrificing Lopes. Senators are now livid, and the investigation is expected to widen. Leading Senators are demanding that Treasury Minister Pedro Malan and current Central Bank president Arminio Fraga, a protégé of George Soros—the speculator who has destroyed nations’ currencies and economies, an advocate of drug legalization, and who manages some of Queen Elizabeth’s vast wealth—be called to testify. Already, President Fernando Henrique Cardoso is trying to put distance between himself and Lopes, insisting that he named Lopes to head the Central Bank in January, only for lack of a better choice.

## Another debt crisis coming

The backdrop to the Lopes scandal is the extremely volatile economic situation in Brazil overall, characterized by a variety of hyperinflationary “solutions” with which the Cardoso government is trying to paper over the its own bankruptcy and that of the country’s financial system:

First, the Cardoso government is moving to take on a huge chunk of private sector foreign debt. In late April, the president of the Bank for National Economic and Social Development announced that the government will guarantee the “best” foreign debt of the private sector corporations, by setting up a special agency which will issue new, 10-year government-backed paper, which foreign creditors will receive in exchange for certain private-sector debts. The new agency will be based in the Cayman Islands, specifically so that taxes will not have to be paid on the new paper, and it will be administered by Citibank. Some \$22.5 billion in private debt, from 90 companies, is estimated to be eligible under this program.

On April 25, Central Banker Fraga held a “long conversation” in Washington with U.S. Federal Reserve Board Chairman Alan Greenspan, in the context of the International Monetary Fund meeting there. In their meeting, Fraga reported, he discussed his plans to continue to deregulate Brazilian financial markets, so as to further Brazil’s integration into the international capital markets.

While giving few details about his plan, Fraga emphasized that he wants to open Brazil further to foreign interests, lift restrictions on financial operations, and eliminate compulsory channeling of credit (for example, to industry or agriculture).

Compounding the financial policy debacle, the government set a super-high interest rate of 11.88% on \$2 billion worth of new five-year bonds it sold in the international markets in late April. This is one of the highest rates ever agreed to by a developing country for a bond issue, and it will rapidly inflate the already-bloated speculative bubble that dominates Brazil’s financial system to even more dangerous levels.

## The Lopes scandal spreads

Brazil’s underlying problem is not a matter of perception, but of very real, generalized insolvency of its financial system. Nevertheless, the Lopes scandal hasn’t exactly helped the Brazilian government’s effort to put a brave public relations face on the looming crisis.

Lopes’s evasion tactics notwithstanding, his refusal to tell the truth before the Senate Committee incriminates him de

facto in the scandalous conduct of the Central Bank on the dollar futures market, especially during the period that preceded the violent devaluation of the peso in January of this year, when 55% of the total foreign exchange positions on Brazil's Commodities and Futures Market were held by the Central Bank, and both President Cardoso and Treasury Secretary Malan knew all about this. The devaluation on Jan. 13 left the Central Bank owing around \$8 billion on futures contracts it had purchased, and gave huge profits to the privileged banks and individuals.

The scandal exploded when it came to light that two banking institutions, Marka and FonteCidam, received subsidized dollars from the Central Bank — i.e., at an exchange rate substantially *lower* than the going market rate — to cover their losses on the dollar futures market. It turns out that it was Luiz Bragança, brother of Sergio Luis Bragança, friend and business partner of “Chico” Lopes, who travelled to Brasilia, together with the owner of Marka Bank, Salvatore Cacciola, to ask for financial help from the Central Bank.

The April 25 issue of the magazine *Epoca*, reports that the brothers Sergio and Luiz Bragança were in turn the conduits for the sale of privileged insider information regarding the upcoming devaluation to various banks, including Marka, FonteCidam, Pactual, and Boavista, information which was supposedly paid for through deposits in a Bahamas account.

But this is just the tip of the iceberg—even though it already adds up to about \$1 billion in shady dealings. In fact, the total devaluation-related losses of the Central Bank on the dollar futures market was about 7.5 billion reals (Brazil's currency, or some \$4 billion at today's currency exchange rate)—although some analysts report that the losses could run as high as 11.4 billion reals. It appears that the Central Bank held the lion's share of all dollar future contracts negotiated on the Brazilian exchange, and that it kept taking such positions even *after* they had decided to devalue—which, of course, provided astronomical profits to privileged banks and individuals who slyly bet for a devaluation of the real.

Among other things, this means that the Central Bank is technically bankrupt, with assets of 3.2 billion reals, and losses of up to four times that amount.

The private banks, however, made out like bandits. Banks such as Garantia, Unibanco, J.P. Morgan, Chase, Itau, and Bank of Boston abruptly changed their market positions on the eve of the devaluation, leading most Brazilians to suspect that the illegal trafficking in insider information was widespread. In addition, 43.5% of the income of foreign banks comes from high-interest government bonds; back in 1994, before Cardoso's nefarious Real Plan was launched, only 4% of their profits came from such instruments.

### **A look at the ‘gang’**

The distinctive characteristic of the Fernando Henrique Cardoso government has been that, behind the image of the honest and immaculate intellectual (he is a French-trained

sociologist), lurk some really huge financial scandals. First, there was the bank bailout program (Proer), through which the banks *Economico* and *Nacional* were rescued, and along with them the Calmon de Sa and Magalhaes Pinto families, whose heir apparent is the President's daughter-in-law.

The government's behavior was no different in the privatization of Telebras, when then-Communications Minister and former banker Luiz Carlos Mendonça de Barros, and president of the National Bank for Economic and Social Development Andres Lara Resende, were caught transmitting privileged information to the Banco Oportunidade, winner of one of the Telebras privatization auctions.

One of the directors at Banco Oportunidade since that time is Persio Arida, former president of the Central Bank, former president of the Bank for National Economic and Social Development, and, above all, a personal friend of Resende and Mendonça de Barros.

The same story repeated itself in the relationship between the Cardoso government and Arminio Fraga, who before taking his current post as president of the Central Bank, was the right-hand man of Soros and, as such, maintained an intimate relationship with the President of the Republic and his economic team. That relationship, of course, gave him first-hand knowledge of the directions of Brazilian monetary policy, always a source of enormous profits.

### **The greatest scandal**

But the greatest scandal of all is the fact that, as a consequence of the repeated government bailouts of the banks, the liquid public debt has already surpassed the half-trillion real mark, a leap of more than 100 billion reals from what it was in December 1998.

This has not gone unnoticed in Brazil. According to the Association of Military Reservists of the state of Paraná, Cardoso and his entire economic team “could be indicted for crimes against the national financial system, under law number 7,492 passed on June 16, 1986, whose Article 4 establishes penalties for the crime of ‘reckless administration of the nation's assets,’ and Article 23, which refers to ‘omitting or delaying official actions by public servants . . . that are necessary for regulating the functioning of the national financial system.’ Both of these are precise characterizations of the macro-economic decisions taken by the responsible monetary authorities (Pedro Malan, Gustavo Franco, Francisco Lopes, Arminio Fraga, etc.) which, over less than four years, led to an imprudent increase in our internal debt of 400 billion reals and an increase of nearly 200 billion reals in our foreign debt, in addition to the frivolous expenditure of more than 103 billion reals, in an irrational attempt to shore up the real's value against the dollar.”

In the face of this scandal, the government's attempt to turn the Marka and FonteCidam banks, and “Chico” Lopes himself, into scapegoats for the whole putrid financial structure, is ridiculous.