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Brazil and the Global Financial Crisis: An Examination of the Effect from Charlotte to Sao Paolo

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I. INTRODUCTION

Within the past decade, the United States' banking community has explored investment opportunities in Brazil and other emerging markets with increasing frequency.[1] Brazil, like China, India, Indonesia, and Russia, has made a "transition from 'developing country' to an 'emerging capital market,'"[2] offering greater opportunities for foreign investment. An emerging market is one in need of external financing to fund its rapid growth and development.[3] Furthermore, it provides a large population and ready market for manufactured goods and technology.[4] Within the global economy, emerging markets provide an open door for businesses to establish long-lasting relationships that will grow as the country develops and prospers.

Emerging markets, such as Brazil, provide new business opportunities for banks in two different ways. First, these markets need commercial banks to provide traditional banking services and to finance industrial development.[5] In Brazil, privatization of state-owned industries has created opportunities for banks to arrange loans to finance the privatization effort.[6] In addition to earning interest,

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1. *See* Rumu Sarkar, *The Legal Implications of Financial Sector Reform in Emerging Capital Markets*, 13 AM. U. INT'L. L. REV. 705, 706-07 (1998); James R. Kraus, *Chase Buys an Investment Operation in Brazil*, AM. BANKER, Jan. 8, 1999, at 1 (discussing Chase Manhattan Corp. purchase of a majority share in a Brazilian investment bank, Banco Patrimonio de Investimento SA); James R. Kraus, *After Long Dry Spell, U.S. Banks on Latin American Acquisition Spree*, AM. BANKER, Nov. 21, 1997, at 4 (stating that several U.S. banks are expanding their operations in Brazil, including American Express Bank, NationsBank, Wachovia, and BankBoston).

2. *See* Sarkar, *supra* note 1, at 705-06.

3. *See International Bank Lending: Hearings Before the House Subcomm. on Fin. Inst. Supervision, Regulation, and Ins., Comm. on Banking, Fin. and Urban Affairs*, 98th Cong. 272 (1983) [hereinafter *Conover Statement*] (statement of C.T. Conover, Comptroller of the Currency).

4. *See id.* at 274.

5. *See id.* at 274-75.

6. *See* David Swafford, *Twin Billions*, LATINFINANCE, June 1998, at 84, *available in*

banks earn high fees for taking part in such loan arrangements.[7] Second, since United States companies are increasingly taking their business to Brazil,[8] banks are moving to the Latin American nation to better serve their customers' needs.[9] By opening branches abroad, banks are helping to facilitate the growth of their customers in emerging markets.

Emerging markets have a tendency to be unstable in their growth, however, due to weak currencies and heavy debt burdens. In the fall of 1998, the economic turmoil in Russia and Asia significantly impacted the Brazilian economy and foreign investors' interest in the area.[10] The beginning of 1999 marked even more trouble for the Brazilian economy when market pressures forced the government to end its four-year experiment with an anti-inflation program.[11] Section II of this Note will explore the reasons that United States businesses, particularly North Carolina-based banks, have been interested in Brazil,[12] and will examine the depth of their involvement in Brazil.[13] Section III will review the recent tumultuous financial problems in Brazil, brought on by the contagion in global financial markets.[14] Section IV will suggest reasons why the global financial community should continue to support Brazil through such efforts as the proposed International Monetary Fund (IMF) rescue plan.[15] Section V of this

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LEXIS, News Library, ASAPII File. For example, NationsBank has acted as financier and arranger of loans in Brazil's privatization process. *See id.*

7. *See Conover Statement, supra* note 3, at 275.

8. *See Treasury Will Not Hold Tax Treaty Talks with Brazil Until Assurances are Met*, BNA INT'L BUS. & FIN. DAILY, Oct. 17, 1995, *available in* LEXIS, News Library, BNAIBF File. This article recounts North Carolina Senator Jesse Helms' attempt to persuade Treasury Secretary Robert Rubin to establish a tax treaty with Brazil in order to serve IBM's operations in Brazil more effectively. *See id;* James R. Kraus, *Chase Buys an Investment Operation in Brazil*, AM. BANKER, Jan. 8, 1999, at 4 (quoting the president of a Brazilian consulting firm as saying that "foreign banks are going after Brazilian investment banks in order to build a position for future business.").

9. *See* James R. Kraus, *Wachovia, Buying Brazil Bank, Concedes International Service is a Must*, AM. BANKER, Jan. 9, 1997, at 8. Hugh Durden, executive vice-president of Wachovia Corporate Services Inc., stated that "what's very clear is that international capabilities and global services will be a key determinant of a bank's ability to maintain and develop large corporate relationships." *Id.*

10. *See infra* notes 82-93 and accompanying text.

11. *See infra* notes 94-105 and accompanying text.

12. *See infra* notes 17-51 and accompanying text.

13. *See infra* notes 52-81 and accompanying text.

14. *See infra* notes 82-122 and accompanying text.

15. *See infra* notes 123-60 and accompanying text.

Note will survey the role of federal agencies and legislation in the regulation of international banking activities.[16]

II. THE GROWING INTEREST IN BRAZIL

A. *Background*

Despite their reputation for economic and political volatility,[17] emerging markets began to capture a larger share of global investments in this decade.[18] The international community considers economies such as Brazil's "as offering a wealth of opportunities in trade, technology, transfers, and foreign direct investment."[19] The head of the investment firm SBC Warburg, Eliazar de Carvalho Filho, stated that "investment banks need to take a long-term view of Brazil. Some may be discouraged by competition but the potential of the market is huge."[20] In 1986, only $25 billion in private capital investments went to emerging market economies.[21] By 1991, however, 36% of all foreign funds earmarked for emerging markets went to Latin America.[22] By 1996 over $250 billion in private capital was allocated to this market.[23] Brazil especially benefited from this growth in foreign investments, witnessing a 69% rise in the Bovespa, the Brazilian equivalent to the Dow Jones Industrial Average, in the first quarter of 1991.[24] By 1997, foreign investments totaled 18% of

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16. *See infra* notes 161-86 and accompanying text.

17. *See, e.g.*, *Argentine Exchange On Top During First Quarter*, THE WORLD BANK WATCH, Apr. 22, 1991, at 1, *available in* LEXIS, News Library, ABBB File (stating that Brazil's stock market lost 68% of its value in 1990, the second biggest drop in the world that year).

18. *See Emerging Markets Showed Biggest Gains in 1990*, LDC DEBT REPORT/LATIN AMERICAN MARKETS, June 3, 1991, at 1, *available in* LEXIS, News Library, ABBB File.

19. Sarkar, *supra* note 1, at 706.

20. Leslie Crawford, *Mandates: Investing in the Future*, FIN. TIMES (London), May 26, 1998, at 3, *available in* LEXIS, Market Library, PROMPT File.

21. *See Hearings on Financial Crisis in Asia Before the House Banking and Financial Services Committee*, 105th Congress 165 (1998) [hereinafter *Summers Statement*] (statement of Lawrence H. Summers, Treasury Deputy Secretary).

22. *See Emerging Market Survey Finds Play Up in Latin Bourses*, LDC DEBT REPORT/LATIN AMERICAN MARKETS, Nov. 25, 1991, at 1, *available in* LEXIS, News Library, ABBB File.

23. *See Summers Statement*, *supra* note 21, at 165.

24. *See Emerging Markets Showed Biggest Gains in 1990*, *supra* note 18, at 1.

Brazil's Gross Domestic Product, up from 15.5% in 1990.[25] United States banks were actively involved in this foreign capital infusion, making a total of $27 billion in loans to Brazil by the end of March of 1998.[26]

What made Brazil attractive to foreign investors and banks was the economic restructuring and stabilization plan that President Fernando Cardoso introduced when he was appointed finance minister in the mid-1990s.[27] Cardoso implemented anti-inflation measures and continued privatization, which allowed foreign investors greater access to large areas of the economy.[28] Cardoso also began the Real Plan,[29] linking Brazilian currency to the dollar.[30] By keeping the exchange rate high, Brazil signaled to the world that it had a robust economy.[31] The exchange rate program stabilized the Brazilian currency and reduced inflation from 40% a month to only 1% for all of 1998.[32] Despite potential problems with an overvalued currency, United States banks expressed great confidence in the Brazilian market in this decade.[33] In addition to the stable currency, Brazil maintained

25. *See Quarterly Report for BNDES Partners*, BNDES NEWS (Aug./Sept. 1998) (visited Oct. 9, 1998) <http://www.bndes.gov.br/english/>.

26. *See Hearings Before the House Banking and Financial Services Committee*, 105th Congress 75 (1998) [hereinafter *Chang Statement*] (statement by Joyce Chang, Emerging Markets Research, Merrill Lynch).

27. *See Brazil's Steady Nerve*, ECONOMIST, Oct. 10, 1998, at 10, 10.

28. *See id.*

29. *See Man of the Year*, LATINFINANCE, July 1998, at 165, *available in* LEXIS, News Library, ASAPII File. Cardoso's plan had three phases: fiscal reform; the introduction of the Real Unit of Value (URV), designed to bring a complex system of indexation in line with a single price adjustment mechanism; and the conversion of the URV into a new currency called the real. *See id.* Prior to Cardoso's plan, Brazil had been unable to make the reforms that other Latin American nations were making, and had created a huge foreign debt. *See* David Mulford, *Credit Suisse First Boston*, LATINFINANCE, July 1998, at 46, *available in* LEXIS, News Library, ASAPII File.

30. *See* Mulford, *supra* note 29, at 46. One analyst called the real "the anchor for the entire economic stabilization program." *Chang Statement*, *supra* note 26, at 75. In early 1999, Brazil abandoned the Real Plan in favor of a free-floating currency. *See infra* notes 94 - 105 and accompanying text.

31. *See* CNNfn, *What's a Devaluation* (Jan. 14, 1999) (visited Jan. 20, 1999) <http://cnnfn.com/worldbiz/9901/14/devaluation_pkg/>.

32. *See* Ed Taylor & Diana I. Gregg, *Brazil: Markets Transfixed by Brazil Fight to Stabilize Currency, Stanch Capital Flight*, BNA INT'L BUS. & FIN. DAILY, Jan. 20, 1999, *available in* LEXIS, News Library, BNAIBF File.

33. *See* James R. Kraus, *Brazil: A South American Giant Finds Its Footing*, AM. BANKER, March 27, 1997, at 9.

sufficient foreign currency reserves to protect itself against panics.[34] Once these reforms were in place, United States companies invested more than $26 billion in that market.[35]

Brazil is a commercial powerhouse in Latin America, with an economy twice the size of both the Russian and Mexican economies.[36] In 1997, Brazil's gross domestic product was almost $800 billion.[37] Furthermore, with 160 million people, Brazil is the world's third most populous democracy, providing a ready market for American products.[38] Brazilian imports of United States' goods and services run at over $14 billion a year.[39] One analyst noted that the Brazilian market is used not only for sales but also as an export base for American multinational companies, 80% of which are involved in some form of business in the South American country.[40] Sao Paolo, the nation's largest city, is the focal point for most of these companies since it is considered South America's business center.[41] Because of these developments, more United States' foreign investment currently goes to Brazil than any other country in Latin America.[42]

34. *See* Peter Passell, *Economic Scene; Private Capital is King in the New Order of World Investment*, N.Y. TIMES, Mar. 21, 1996, at D2.

35. *See* Thomas Omestad, *Will Brazil Produce the Samba Effect?*, U.S. NEWS & WORLD REP., Sept. 28, 1998, at 52, 52.

36. *See id.* Hugh M. Durden, president of Wachovia Corporation's corporate banking division, stated that "historically there has been more volatility and less stability in Brazil, but the fact remains that Brazil has the largest and most diverse economy in Latin America." *See* Kraus, *Brazil: A South American Giant Finds Its Footing*, *supra* note 33, at 9.

37. *See id.* In comparison, the total gross domestic product of Latin America and the Caribbean Basin was about $1.5 trillion in 1994. *See Why Free Trade in the Americas? Why NAFTA?*, BUS. AM., Aug. 1996, at 4, *available in* LEXIS, News Library, MAGS File.

38. David Adams, *Here's Why What Happens in Brazil Matters to U.S.*, ST. PETERSBURG TIMES, Oct. 6, 1998, at 2A. Democracies make better markets for American products because they are more open forms of government that provide opportunities for corporations to establish a long-term trade relationship. *See id.*

39. *See Brazil: Ex-IM Bank President Harmon Says Brazil Could Become Leading Client*, BNA INT'L BUS. & FIN. DAILY, Oct. 28, 1998, *available in* LEXIS, News Library, BNAIBF File.

40. *See* Adams, *supra* note 38, at 2A (quoting Jerry Haar, director of the Inter-American Business and Labor Program at the University of Miami's North-South Center).

41. *See Sao Paulo: Brazil's Troubled Megalopolis*, ECONOMIST, May 23, 1998, at 34, 34.

42. *See id.*

B. *Growing Interest of U.S. Firms*

The positive outlook for growth of the Brazilian market in the 1990s drew the notice of both American corporations and their bankers.[43] David L. Aaron noted that the Latin America countries are "now the hot market for U.S companies."[44] Notably, United States export growth to the Latin American nations has grown by 150% since 1990.[45] Large national banks such as Citicorp[46] and BankBoston Corp. (BankBoston) also expanded their operations in Brazil in the mid-1990s.[47] By the end of 1997, BankBoston had more than $13 billion of assets in Latin America while Citicorp had $28 billion.[48] In 1998, BankBoston was the fifth largest mutual fund company in Brazil with $6 billion in funds.[49] The cross-border lending exposure of the seven large regional banks[50] to Brazil was $5.1 billion in June of 1998.[51]

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43. *See* Kraus, *Brazil: A South American Giant Finds Its Footing*, *supra* note 33, at 9.

44. *See Aaron Sees Shift in Greatest Opportunities for U.S. Businesses to Western Hemisphere*, BNA INT'L BUS. & FIN. DAILY, May 13, 1998, *available in* LEXIS, News Library, BNAIBF File. David L. Aaron is the Commerce Undersecretary for International Trade. *See id.*

45. *See id.*

46. *See generally* James R. Kraus, *In a Shift, Citicorp Now Shopping Around for Banks in Foreign Countries*, AM. BANKER, May 1, 1997, at 10 (stating that the reason for Citicorp's interest in foreign financial institutions is the range of possibilities with emerging markets).

47. *See id.* Henrique de Campos Meirelles, the Brazilian-born president of BankBoston, said that the reason the bank began to make ties with Latin America is "because we have access to a growing economy, a growing money supply, and a growing market share." James R. Kraus, *Globetrotter*, AM. BANKER, Dec. 18, 1997, at 18.

48. *See* James R. Kraus, *BankBoston Charging Ahead in Latin America Despite Crisis*, AM. BANKER, Nov. 13, 1997, at 1.

49. *See* James R. Kraus, *Banks Start Cutting Back Staff Abroad*, AM. BANKER, Oct. 15, 1998, at 1.

50. *See* Tania Padgett, *Investors Dump Big Banks on Brazil Devaluation Fears*, AM. BANKER, Oct. 28, 1998, at 28. The seven large regional banks include the old BankAmerica Corp., BankBoston Corp., First Union Corp., formerly CoreStates Financial Corp., Bank of New York Co., Republic New York Corp., and State Street Corp. *See id.*

51. *See id.* This exposure includes "credit exposure on and off the balance sheet, which includes loans, derivatives, and other securities." *Id.*

C. *Investment in Brazil by North Carolina-based Banks*

Along with Citibank and BankBoston's corporate customers, North Carolina businesses have increased their presence in Brazil in the past decade.[52] In response, North Carolina banks have become increasingly involved in Brazil, either by assisting in loan packages, opening branches, or purchasing banks. In December of 1997, Wachovia Corp. (Wachovia) became the first North Carolina-based bank, and the first bank in the United States, to acquire a Brazilian bank, Banco Portugues de Atlantico-Brasil SA.[53] The Brazilian branch, Banco Wachovia, focuses on trade finance and service to Wachovia's multinational corporate clients.[54] Hugh Durden, the executive vice president and head of Wachovia Corporate Services Inc., stated that Wachovia's corporate customers greatly needed international services.[55] Durden emphasized that "Brazil has been one of the top three markets for trade and investment activity [by Wachovia clients] over the last several years, and this trend is expected to continue."[56]

Following closely behind Wachovia, Charlotte-based NationsBank Corp. (NationsBank), now known as BankAmerica after its merger with California-based Bank of America, purchased a 51% stake in Banco Liberal in January of 1998.[57] The bank had already opened a representative office in Sao Paolo, Brazil's capital, in July of

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52. *See Treasury Will Not Hold Tax Treaty Talks with Brazil Until Assurances are Met*, BNA INT'L BUS. & FIN. DAILY, Oct. 17, 1995, at 1, *available in* LEXIS, News Library, BNAIBF File.

53. *See In Brief: Wachovia Wraps up Brazilian Bank Deal*, AM. BANKER, Dec. 18, 1997, at 9.

54. *See id.*

55. *See* James R. Kraus, *Wachovia: Buying Brazil Banks, Concedes International Service Is a Must*, AM. BANKER, Jan. 9, 1997, at 8. Durden said "the trade finance capabilities of Banco Wachovia, combined with Wachovia's enhanced global service capabilities, will enable us to serve as a leading global financial services partner for customers as they expand their multinational businesses in the Mercosul trade region." *Id. See also Wachovia Completes Acquisition of Brazilian Bank*, PR NEWSWIRE, Dec. 5, 1997, *available in* LEXIS, News Library, ASAPII File. The countries of Argentina, Brazil, Paraguay, and Uruguay make up the Mercosul free-trade region, representing 200 million people. *See id.*

56. *See* Kraus, *Wachovia: Buying Brazil Banks, Concedes International Service Is a Must*, *supra* note 55, at 8.

57. *See* James R. Kraus, *NationsBank Buys Into Brazil, Continuing U.S. Return to Region*, AM. BANKER, Jan. 28, 1998, at 1.

1997.[58] Banco Liberal serves as "a platform for further developing activities" in a nation where many of its American clients are expanding.[59] A representative for the bank said that the purchase "allows us to serve our U.S. clients more effectively, gives us a foothold in an extremely active market, and allows us to participate in an enormous number of privatizations expected to take place over the next three to four years."[60] The bank is opening offices throughout Brazil to build relationships with local enterprises in addition to serving their current customers.[61] As of November 30, 1998, the total exposure of BankAmerica to Brazil totaled over $3 billion.[62]

First Union Corp. (First Union), also based in Charlotte, has expanded its operations in Brazil. Most of its contact comes through its Miami office, which serves as a "gateway to Latin America."[63]

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58. *See* Michael Kepp & James R. Kraus, *NationsBank Widens Focus to Include Latin America*, AM. BANKER, Jul. 24, 1997, at 1. In 1998, NationsBank merged with BankAmerica, which has $11.3 billion in cross-border lending exposure to Latin America. *See NationsBank and BankAmerica Off Standard & Poor's Watch*, PR NEWSWIRE, Sept. 23, 1998, *available in* LEXIS, News Library, ASAPII File.

59. *See* Kraus, *NationsBank Buys Into Brazil, Continuing U.S. Return to Region*, *supra* note 57, at 1.

60. *Id.* About 30% of NationsBank corporate clients are involved in business in Latin America, and about 300 of those clients are specifically involved in Brazil. *See id.*

61. *See* Kepp & Kraus, *supra* note 58, at 1. Robert D. Bailey, the senior international banking executive for NationsBank, explained, "if you just stick to U.S. businesses, you're not going to get any new business." *Id.* He estimated that NationsBank had about 300 corporate clients who were considering broadening their business in Brazil. *See* Kraus, *Chase Buys an Investment Operation in Brazil*, *supra* note 1, at 4.

62. *See* BANKAMERICA CORP., QUARTERLY REPORT: SEC FORM 10-Q (Nov. 30, 1998), *available in* EDGAR (visited Nov. 30, 1998) <http://www.edgar-online.com/brand/yahoo/search/?sym=bac>. BankAmerica's exposure to Latin America is sizable, with over $42 billion at risk. *See id.* In comparison, BankAmerica's total exposure to all of Asia is only $28 billion. *See id.*

63. *First Union International Banking* (1998) (visited Oct. 9, 1998) <http://www.firstunion.com/international/advantage.html>. First Union's recent quarterly statement notes the bank's modest exposure to international markets:

> Further, a longstanding strategy that focuses on our middle-market client base has enabled us to limit our credit exposures to areas of recent public concern, such as emerging markets and hedge funds. The greatest impact of the quarter's market movements was seen in our commercial real estate loans held for securitization. If the financial markets continue to be volatile, we would expect to be modestly impacted in the future.

FIRST UNION CORP., QUARTERLY REPORT: SEC FORM 10-Q (Nov. 13, 1998), *available in* EDGAR, (visited Nov. 30, 1998) <http://www.edgar-online.com/brand/yahoo/search/?sym=ftu>.

Notably, the chair and chief executive of First Union, Ed Crutchfield, suggested that the future of banking should include a "consolidation on a worldwide scale by striking alliances and eventually merging with foreign institutions."[64] First Union's Latin American expansion is more moderate than BankAmerica or Wachovia with about $1.3 billion worth of approved trade credit lines to all of Latin America in 1997.[65] One possible reason for this lesser degree of involvement is that Banco Santander, a Spain-based bank heavily involved in Brazil,[66] formerly owned a large share of First Union stock. In September of 1997, the bank sold all of its First Union common stock holdings.[67]

Brazil's commitment to privatize state-owned businesses is another reason that United States banks are involved in Brazil.[68] Since the early nineties, the Brazilian government has sold its majority stake in many of its energy, utility, and transportation systems.[69] When President Cardoso was first elected, he persisted in the privatization plan that was underway before he came into office.[70] Now that he has

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64. James R. Kraus, *Citi Buying $22M-Asset Hungarian Bank; Deal Would Make It 8th Largest in Country*, AM. BANKER, May 27, 1998, at 28.

65. *See* James R. Kraus, *Regionals Flock to Miami with Eye on Latin Business*, AM. BANKER, Mar. 6, 1997, at 7.

66. *See Transium First Union Bank* (1998) (visited Oct. 20, 1998) <http://secure.transium.com/background>.

67. *See First Union International Banking* (1998) (visited Oct. 9, 1998) <http://www.firstunion.com/library/newpress/970919.html>.

68. *See Brazil's Steady Nerve*, ECONOMIST, Oct. 13, 1998, at 1, 1. State-owned businesses that have been sold include railways, mining, electricity, telecoms, banks, and ports. *See id.* Brazil's privatization program has increased foreign financing of the budget deficit. *See* Susan McInerney & Diana I. Gregg, *Brazil: More Self-Reliant Than the Market Thinks*, EMERGING MARKETS DEBT REPORT, Sept. 28, 1998, at 1, *available in* LEXIS, News Library, ABBB File.

69. *See Brazil Turnaround Close, Salomon Assessment Says*, LDC DEBT REPORT/LATIN AMERICAN MARKETS, Jan. 20, 1991, at 7, *available in* LEXIS, News Library, ABBB File. Privatization not only allowed foreign capital to flow into the economy, it also increased the government's reserves. Investors are more willing to put their capital into Brazil because of the reserves it holds. *See Brazil: Banking Group Sees Large Package for Brazil, Predicts Modest Recession*, BNA INT'L BUS. & FIN. DAILY, Oct. 1, 1998, *available in* LEXIS, News Library, BNAIBF File. Although Brazil's short-term debt was approximately $50 billion as of mid-1998, it had about $50 billion in usable reserves. *See id.* In contrast, Korea, another emerging economy, had $80 billion in debt but only $6 billion in usable reserves. *See id.*

70. *See Communications: Brazil Exceeds Expectations, Opens Up Huge Market With $19 Billion Telebras Sale*, BNA INT'L BUS. & FIN. DAILY, Aug. 5, 1998, *available in* LEXIS, News Library, BNAIBF File. The government's 51% share in the telephone company sold for $19.01 billion, of which $13.3 billion came from foreign companies. *See id.*

been re-elected, continued privatization is virtually assured.[71] In 1998, foreign participation in privatization amounted to 35% of the total proceeds.[72] Banks can garner fees up to 1.5% of the total sale for helping to arrange the loans for privatization.[73] In the largest incident of privatization yet, Morgan Stanley and Salomon Brothers collected a fee between $20 and $40 million for assisting in the sale of Telebras, a telecommunications company.[74]

North Carolina banks are among those playing an important role in privatization. In May of 1997, NationsBank assisted in the sale of Companhia Vale do Rio Doce, a mining company, by financing a loan worth over $1 billion.[75] NationsBank also financed the privatization of Companhia Paulista de Forca e Luz, an electric utility in the state of Sao Paolo.[76] The $1.2 billion loan went to VBC Energia, a Brazilian investment group.[77] In addition, NationsBank helped finance the privatization of the state-owned crude oil company, Petrozuata, in a $1.45 billion deal.[78] Both Wachovia and NationsBank were joint arrangers in a loan for a cellular license bid made by BellSouth and Banco Safra team in 1998.[79] Such privatizations are just the beginning; Brazil has many more industries to auction off to the highest bidder.[80] Analysts also predict that investment bankers will be needed to assist with the future consolidation of the privatized companies that will create a new surge of mergers and acquisitions.[81]

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71. *See* Omestad, *supra* note 35, at 52.

72. *See Telebras: World's Largest Privatization of All Time*, BNDES NEWS, Aug.-Sept. 1998, at 1.

73. *See* Crawford, *supra* note 20, at 3.

74. *See id.* Some analysts noted, however, that this sale was only 0.07% of the sale profit, which was an unusually low fee for this type of transaction. *See id.* One reason for the lower fees is that there is fierce competition to assist in privatization. *See id.*

75. *See NationsBank Shows Advantages of Being a Big Bank*, GAZETA MERCANTILE ONLINE, May 26, 1997, *available in* LEXIS, News Library, GAZDLY File.

76. *See* Swafford, *supra* note 6, at 118.

77. *See id.*

78. *See Deals of the Year*, LATINFINANCE, July 1998, at 206, *available in* LEXIS, News Library, ASAPII File.

79. *See Loan of the Month*, LATINFINANCE, June 1998, at 84, *available in* LEXIS, News Library, ASAPII File. The total transaction was worth $1.75 billion. *See id.*

80. *See* Crawford, *supra* note 20, at 3. The Sao Paolo sewerage and water treatment utility, Sabesp, is considered the next government-owned industry to be privatized. *See id.*

81. *See id.*

III. THE EFFECT OF THE GLOBAL CREDIT CRUNCH ON BRAZIL

The collapse of the Asian and Russian economies in 1998 brought stinging losses to United States banks that had invested abroad.[82] Rumors that Brazil planned to devalue the real as part of its economic austerity program placed downward pressure on the stock prices of major United States banks in the Fall of 1998.[83] Furthermore, Brazil increased its interest rates to avoid devaluation,[84] causing "market nervousness" about the overvaluation of the Brazilian currency.[85] The previous rumors about devaluation became reality in January of 1999, again implicating the stock prices of major United States banks.[86]

Out of fears arising from this climate of risk, investors and lenders retreated from emerging markets, creating the potential for a global credit shortage.[87] Because of worldwide economic difficulties, United States banks became increasingly risk averse, cutting off the flow of credit and loans extended to other emerging nations.[88] The effects of this capital flight may be seen particularly in Brazil.[89] In August of 1998, the country experienced $12 billion in capital

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82. *See* James R. Kraus, *U.S. Bankers Say Emerging Nations Must Tighten Rules*, AM. BANKER, Oct. 6, 1998, at 1.

83. *See* Padgett, *supra* note 50, at 28.

84. *See East Asian Economic Conditions: Hearings Before the House Comm. on Banking and Fin. Serv.*, 105th Cong. 98 (1998) [hereinafter *East Asian Economic Hearings*] (statement of Robert B. Zoelick, President and CEO-designate, Center for Strategic and International Studies). The central bank of Brazil increased the annual prime lending rate from 19.75% to 49.75% in September of 1998. *See Brazilian Leader Confident G-7 Will Offer IMF Resources*, 71 Banking Rep. (BNA) 11 (Sept. 28, 1998).

85. *East Asian Economic Hearings*, *supra* note 84.

86. *See* Timothy L. O'Brien, *The Markets: Stocks and Bonds; Despite Brief Comeback, Bank Shares Continue to Slide*, N.Y. TIMES, Aug. 22, 1998, at D3. *See also Stocks: Brazil Crisis Overshadows 4Q Reports, Sinking Bank Stocks for a Second Day*, ECONOMIST, Jan. 15, 1999, at M1 (BankAmerica, for example, lost almost $3 per share in a single day of trading).

87. *See* Richard W. Stevenson, *The Markets: Federal Reserve Lowers Key Rate by Quarter-point*, N.Y. TIMES, Sept. 30, 1998, at A1. Michael Moskow, president of the Federal Reserve Bank of Chicago, pointed out that investors mood for taking risks has markedly declined. *See id.*

88. *See id. See also* Steven Mufson, *Economic Crisis Adds New Fears*, WASH. POST, Oct. 5, 1998, at A1 (describing commercial bankers' negative reactions to the economic crisis). *See generally* Stevenson, *supra* note 87, at A1 (describing the reasons the Federal Reserve cut interest rates).

89. *See Chang Statement*, *supra* note 26, at 79. Between August and November of 1998, Brazil experienced more than $22 billion in foreign capital outflows. *See id.*

outflows, followed by $10 billion more in just the first ten days of September.[90] By the end of the month, the Brazilian stock market had dropped 15.82%.[91] Capital flight made it difficult for industries to obtain financing, particularly since interest rates were soaring in Latin America.[92] Investors also turned away from the Brazilian stock market, creating an even greater need for foreign direct investment.[93]

When the inevitable devaluation occurred in January of 1999,[94] Brazil finally succumbed to currency pressure and abandoned the Real Plan.[95] Immediately after announcing the new monetary policy, Brazil experienced major currency outflows, totaling about $3 billion in just two days.[96] In addition, the central bank's reserves fell to $40 billion as the government attempted to stop a massive devaluation of the real.[97] Initially, the government tried to direct a quite modest devaluation but found that it could not effectively control the exchange rate.[98] Brazil subsequently announced that it would permit the real to

90. *See id.*

91. *See* Diana Jean Schemo, *The Markets: Stocks in Brazil Rally, Buoying Latin Markets*, N.Y. TIMES, Sept. 16, 1998, at C1.

92. *See* Sharon Harvey Rosenberg, *South Florida Banks Tread Warily as Latin America Reacts to Asia Crisis*, BROWARD DAILY BUS. REV., Sept. 22, 1998, at A2, *available in* LEXIS, Busfin Library, Fllaw File. *See also* Susan McInerney & Mark Felsenthal, *G-7: G-7 Support of Clinton Plan Nudges Investors Back to Emerging Markets*, BNA INT'L BUS. & FIN. DAILY, Nov. 3, 1998, *available in* LEXIS, News Library, BNAIBF File (discussing attempts to ease interest rates in emerging markets).

93. *See* Laura Mandaro, *Keen Interest, Fewer Opportunities and Financial Risk*, THOMSON'S INT'L BANKER, Oct. 12, 1998, at 1, available in LEXIS, News Library, ABBB File.

94. *See* Taylor & Gregg, *Brazil: Markets Transfixed by Brazil Fight to Stabilize Currency, Stanch Capital Flight*, *supra* note 32. Devaluation is defined as a considerable decline in a currency's value when compared to either the value of gold or the value of another country. *See* CNNfn, *What's a Devaluation*, *supra* note 31. A positive result of devaluation is that it makes the country's products more competitive on the world market, since they are less expensive. *See id.* Ideally, the country's economy will grow faster because it will sell more of its goods on the market. *See id.* However, to investors, devaluation signifies a weak currency, and therefore, a weak economy. *See id.*

95. *See* Taylor & Gregg, *Brazil: Markets Transfixed by Brazil Fight to Stabilize Currency, Stanch Capital Flight*, *supra* note 32. *See also supra* notes 29-32 and accompanying text (discussing the Real Plan).

96. *See* CNNfn, *Real Floating Free of Band*, (Jan. 15, 1999) (visited Jan. 20, 1999) <http://cnnfn.com/markets/9901/15/real/>.

97. *See id.* If the government's reserves continue to decline, the country could have a difficult time meeting its debt obligations internationally. *See* CNNfn, *Strong Gains on Wall Street*, (Jan. 15, 1999) (visited Jan. 20, 1999) <http://cnnfn.com/markets/9901/15/marketwrap/>. This would jeopardize the IMF rescue package, since paying interest on accrued debts is a condition of receiving the total amount. *See id.*

98. *See* Taylor & Gregg, *Brazil: Markets Transfixed by Brazil Fight to Stabilize

float freely, allowing the market to determine the exchange rate.[99]

The complete abandonment of the anti-inflation plan was caused by market pressures and growing fears of shrinking reserves.[100] The central bank president, Francisco Lopes,[101] reasoned that the free floating real allows for more flexibility for the financial market to fix the exchange rate.[102] Upon news of the new monetary policy, stock markets around the world began to recover from the losses caused by the initial turmoil.[103] Brazilian investors were relieved to hear that the government would no longer use their reserves to support the weakened currency.[104] This relief was apparent when Brazilian stocks increased 33.4% within two days after the devaluation announcement.[105]

While the devaluation may ease interest rates in Brazil,[106] it has caused inflation to soar and could lead the nation into a recession.[107]

Currency, Stanch Capital Flight, *supra* note 32.

99. *See* Stephen Fidler & Geoff Dyer, *Brazil Moves to Limit Damage*, FIN. TIMES (N.Y.), Jan. 18, 1999, at 1. Because Brazil is allowing the real to float, it will not have to use its reserves to buy reals and sell dollars in an effort to support its currency. *See* CNNfn, *Strong Gains on Wall Street*, *supra* note 97.

100. *See* Geoff Dyer & Phillip Cogan, *Brazil is Forced to Allow Float of Real*, FIN. TIMES (London), Jan. 16, 1999, at 1, *available in* LEXIS, Bankng Library, Fintme File. Under Cardoso's plan, Brazil was using its currency reserves to maintain the value of the real. *See id.* Investors reacted positively to the news that the government would no longer use its reserves to defend the exchange rate. *See id.*

101. The Brazilian Senate elected Francisco Lopes on January 13, 1999. *See* Ed Taylor, *Brazil: Market Cheers as Brazil Removes Lopes from Bank Post, Puts in Soros Fund's Fraga*, BNA INT'L BUS. & FIN. DAILY, Feb. 4, 1999, *available in* LEXIS, News Library, BNAIBF File. On January 29, 1999, Arminio Fraga, the former managing director of the investment fund Soros Fund Management, subsequently replaced him. *See id.*

102. *See* Ed Taylor & Diana Gregg, *Brazil: Brazil Effectively Devalues Currency; Action Creates Widespread Concerns*, BNA INT'L BUS. & FIN. DAILY, Jan. 14, 1999, *available in* LEXIS, News Library, BNAIBF File.

103. *See* Dyer & Cogan, *supra* note 100.

104. *See* CNNfn, *Real Relief for Latin Stocks*, (Jan. 15, 1999) (visited Jan. 20, 1999) <http://cnnfn.com/worldbiz/9901/15/americas/>.

105. *See id.*

106. *See* John Barham, *Back to Reality in Sao Paulo*, FIN. TIMES (N.Y.), Jan. 18, 1999, at 19.

107. *See* Geoff Dyer, *Brazil Fights to Rebuild Credibility*, FIN. TIMES (N.Y.), Jan. 18, 1999, at 4. *See also* Alan Beattie, *All Eyes on Brazil*, FIN. TIMES (London), Jan. 18, 1999, at 28, *available in* LEXIS, Bankng Library, Fintme File (stating that devaluation threatens Argentine exports to Brazil since the real will lose its competitiveness); Taylor & Gregg, *Brazil: Brazil Effectively Devalues Currency; Action Creates Widespread Concerns*, *supra* note 102 (quoting Kurt Karl, head of Global Economic Services with WEPA, Inc., who predicts a severe recession in Brazil as a result of the attempt to

The biggest uncertainty is determining how much Brazil's economic crisis will significantly impact the rest of Latin America, and possibly the world. Economists fear that devaluation will materially effect the nearby economies of Argentina and Mexico.[108] In the first week of devaluation, Argentine banks raised their interest rates 50% due to the increased cost of making loans.[109] Since borrowers will not be able to get as many dollars for their reals, they will have trouble repaying their loans or making interest payments on securities.[110] In addition to increasing Argentina's interest rates, the devaluation also threatens Argentina's exports to Brazil, since inflation will increase the cost of those exports.[111]

The immediate impact of Brazil's devaluation decision on American businesses was mixed.[112] Some analysts believe that Brazil's troubles will have a marked impact on the United States economy because of the United States' major trade links with Brazil.[113] If Brazil falls into a prolonged recession, United States companies may be materially affected since 20% of Brazil's trade is with the United States.[114] Upon news of the Central Bank President's resignation and the government's decision to devalue, banking companies substantially

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stabilize their economy).

108. *See Argentina: Argentine Banks Lift Rates 50% Following Brazil's Real Devaluation*, BNA INT'L BUS. & FIN. DAILY, Jan. 22, 1999, *available in* LEXIS, News Library, BNAIBF File. *See also* Diana I. Gregg, *Brazil: IDB Clears Record Loan for Brazil as Cardoso Urges Emergency Fund*, BNA INT'L BUS. & FIN. DAILY, Sept. 25, 1998, *available in* LEXIS, News Library, BNAIBF File (discussing economists fears of devaluation's impact upon the Argentine and Mexican economies). Since Brazil is the economic powerhouse of Latin America, the devaluation of the real would affect the currency of neighboring countries, and spark capital flight from those countries. *See* Diana I. Gregg, *IMF: Camdessus Says IMF Moving Closer to Accord on Brazilian Economic Package*, BNA INT'L BUS. & FIN. DAILY, Oct. 9, 1998, *available in* LEXIS, News Library, BNAIBF File.

109. *See Argentina: Argentine Banks Lift Rates 50% Following Brazil's Real Devaluation*, *supra* note 108.

110. *See* Padgett, *supra* note 50, at 28.

111. *See* Beattie, *supra* note 107, at 28. *See also* James R. Kraus, *U.S. Banks Say Brazil's Troubles Mean Opportunity, Not Losses*, AM. BANKER, Jan. 19, 1999, at 33 (stating that Brazil receives one third of Argentina's exports).

112. *See* Karen Talley, *Brazil Giving Banks in U.S. a Flashback to July Meltdown*, AM. BANKER, Jan. 14, 1999, at 1.

113. *See* Taylor & Gregg, *Brazil: Brazil Effectively Devalues Currency; Action Creates Widespread Concerns*, *supra* note 102 (quoting Kurt Karl, head of Global Economic Services with WEFA, Inc.).

114. *See* Adams, *supra* note 38, at 2A.

involved in Latin America witnessed a decline in their stock price.[115] Both First Union Corp. and Wachovia have seen their shares decline as investors shied away from international markets.[116] Furthermore, the credit rating agency, Standard & Poor Corp. adjusted its rating to "negative" for eight large banks that had significant ties to Brazil.[117] In addition, corporations who invested heavily in Brazil may see their 1999 earnings damaged by the devaluation.[118]

In the worse case scenario, Brazil's currency could continue to fall, causing severe inflation and triggering a painful recession.[119] The Real Plan was an effort to reduce the high inflation Brazil experienced in the 1980s and early 1990s.[120] Abandoning the plan may result in a real with anemic purchasing power.[121] A prolonged recession in Brazil would negatively impact United States bank's earnings going forward.[122] Furthermore, if interest rates decrease, foreign investors who had been attracted by higher interest rates may abandon Brazil.

115. *See* Talley, *Brazil Giving Banks in U.S. a Flashback to July Meltdown*, *supra* note 112, at 1. Citigroup stock, for example, declined by $3.50 to $52.1875. *See id.* BankBoston Corp.'s stock price, however, had risen by the end of the trading day after the release of a positive statement to the public. *See id.*

116. *See* Karen Talley, *Stocks: Brazil Crisis Overshadows 4Q Reports, Sinking Bank Stocks for a Second Day*, AM. BANKER, Jan. 15, 1999, at 1. An investment officer with Grey, Siefert, however, noted that "this is the ideal environment for banks - no inflation, decent earnings, and the economy is showing moderate growth." *Id.*

117. *See* Aaron Elstein, *S&P Sees 'Negative' Outlook for 8 Big Banks with Substantial Brazil and Latin Exposure*, AM. BANKER, Jan. 15, 1999, at 24. The eight banks were Citigroup, J.P. Morgan & Co., BankBoston Corp., ABN Amro NV, Dresdner Bank AG, Societe Generale, Banco Santander (Spain), and Banco Bilbao Vizcaya (Spain). *See id.* Tanya Azarchs, a Standard & Poor's banking analyst, stated that Brazil's turmoil is expected to impact many Latin American countries' economies. *See id.* Consequently, Standard & Poor's also gave "negative" ratings to Mexico's two largest banks, Banamex-Accival and Bancomer. *See id.*

118. *See Brazil's Currency Moves to Affect First Quarter*, WALL ST. J., Jan. 21, 1999, at B14. BellSouth Corp., an investor in wireless properties, issued a statement saying that it anticipates its first quarter earnings to be negatively affected by the Brazilian devaluation. *See id.*

119. *See* Taylor & Gregg, *Brazil: Markets Transfixed by Brazil Fight to Stabilize Currency, Stanch Capital Flight*, *supra* note 32.

120. *See supra* notes 29-32 and accompanying text.

121. *See* CNNfn, *Brazil's Real May Fall Further*, (Jan. 22, 1999) (visited Jan. 22, 1999) <http://cnnfn.com/worldbiz/emerging_markets/9901/22/brazil_analysis/>.

122. *See Chase Urges Quick Reforms in Brazil*, AM. BANKER, Jan. 21, 1999, at 22 (citing commentary by sources at Chase Manhattan Corp.).

IV. THE IMPORTANCE OF CONTINUED ENGAGEMENT OF BRAZIL BY THE GLOBAL FINANCIAL COMMUNITY; THE PROPOSED IMF PLAN

A. *Brazil's Need for Global Financial Support*

The foregoing problems present a difficult case, at least in the short term, for continued investment by United States banks in Brazil and Latin America. Given the lending-related losses already incurred and the growing instability in these emerging markets, banks are reconsidering their involvement in this part of the hemisphere.[123] Understandably, banks and other financial institutions, held continually accountable by shareholders, do not wish to underwrite the risks associated with the increasing global contagion. Notwithstanding the persuasive case for disengagement, particularly for United States banks, several countervailing considerations counsel continued engagement by the global financial community to help Brazil through this difficult period.

First, in recent years United States companies, including banks, have continually expressed confidence in the future of Brazil's growth.[124] The underlying rationale for optimism in Brazil, at least for the long term, is still valid. Some firms see the recent problems as an opportunity, rather than as a harbinger of financial disaster. For example, despite the January 1999 devaluation, the chairman and chief executive officer of BellSouth stated that he was "convinced our Latin American investments will continue to be a growth engine for us as we enter the new millenium."[125] BankBoston reported that "we remain confident in our near-term performance in Brazil, and our outlook for the remainder of the year continues to be positive."[126] Banco Santander, a Spain-based bank, indicated that it plans to continue to

123. *See, e.g.*, Rick Brooks, *BankAmerica Retreats from Overseas Markets*, WALL ST. J., Jan. 22, 1999, at A2. BankAmerica insiders reported that due to $433 million in trading losses over the past two quarters, BankAmerica would be reducing its risk to overseas markets in general. *See id.*

124. *See supra* notes 19-42 and accompanying text.

125. *BellSouth Recognizes Brazilian Currency Devaluation, Remains Confident of Growth Potential for Brazil and Latin America*, PR NEWSWIRE, Jan. 20, 1999, at 7356, *available* in LEXIS, News Library, ASAPII File (quoting Duane Ackerman).

126. Kraus, *U.S. Banks Say Brazil's Troubles Mean Opportunity, Not Losses*, *supra* note 111, at 33.

expand its operations in Brazil.[127] In fact, some banks are participating in large loans to Brazil, in order to prevent further deterioration of the Brazilian economy.[128]

Second, Brazil, like other fledgling capitalistic markets, deserves support from its more experienced global partners, including the United States. The recent IMF rescue plan, discussed below,[129] appears to have signaled the commitment of the global financial community to Brazil and its continuing efforts of reform. As Joel L. Naroff, chief bank economist at First Union stated, "sometimes you have to take extraordinary measures to counteract what's happening. . . . Sometimes you just have to take a stand."[130] Continued foreign direct investment is crucial for Brazil in light of its experience with capital flight.[131] Given the presence of American business interests in Brazil,[132] including North Carolina-based money-center banks,[133] this endeavor is not just altruistic in nature.

Finally, foreign investors and lending institutions should draw some assurances from the excess capital held by large Brazilian banks that can be used to counteract the effects of devaluation.[134] Of the largest banks, only Unibanco is highly leveraged.[135] Unibanco is considered the weakest of the big banks because it depends more heavily on foreign currency than the others.[136] Even this bank,

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127. *See Spanish Bank's Plans Unshaken by Brazil Woes*, AM. BANKER, Jan. 21, 1999, at 22. Banco Santander will merge with Banco Hispanoamericano. *See id.* The chief executive officer of Santander Investment Securities, Inc., Ricardo Mandelbaum, believes that Brazil's problems are merely short-term and will not inhibit future growth in Latin America. *See id.*

128. *See* Gregg, *Brazil: IDB Clears Record Loan for Brazil as Cardoso Urges Emergency Fund*, *supra* note 108. James Wolfenson, president of the World Bank, told the press that the bank will be taking part in a loan package for Brazil. *See id.* Banco Santander, based in Spain, has hinted at its own aid package to Brazil. *See* Mandaro, *supra* note 93, at 1.

129. *See infra* notes 138-60 and accompanying text.

130. Matthew Lubanko et al., *Avoiding the Domino Effect; The Big Players in International Finance Step In to Keep Brazil's Economy Afloat*, HARTFORD COURANT, Sept. 30, 1998, at A1, *available in* LEXIS, News Library, Htcour File.

131. *See* Mandaro, *supra* note 93 (citing Gustavo Franco, Central Bank governor, at the World Bank/IMF meetings).

132. *See supra* notes 17-51 and accompanying text.

133. *See supra* notes 52-81 and accompanying text.

134. *See* Barham, *Back to Reality in Sao Paulo*, *supra* note 106, at 19.

135. *See id.* Unibanco is Brazil's third largest bank. *See id.*

136. *See* John Barham, *Brazilian Bank Raises Profit Despite Growing Volatility*, FIN. TIMES (London), Jan. 25, 1999, at 22, *available in* LEXIS, Bankng Library, Fintme File.

however, is prepared to deal with devaluation since much of its loan portfolio is made up of dollar-based trade finance operations.[137]

B. The Proposed IMF Plan

The hastily devised IMF rescue plan symbolizes the global financial community's recognition of Brazil's importance to economies worldwide.[138] The package includes almost $42 billion in aid, part of which has already been made available to Brazil.[139] The IMF will contribute $18 billion, the World Bank[140] and the Inter-American Development Bank[141] will each contribute $4.5 billion, and twenty other countries will together furnish $14.5 billion.[142] The United States will contribute $5 billion of the latter amount.[143] The loan is meant to "help slow capital flight from Brazil and prevent the current global financial crisis from spreading into Latin America."[144]

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137. *See id.*

138. *See* Gregg, *IMF: Camdessus Says IMF Moving Closer to Accord on Brazilian Economic Package*, *supra* note 108. The IMF is a Washington D.C.-based lending institution composed of a 182-country member base which provides currency stabilization for troubled economies through its lending program. *See* David E. Driscoll, *What Is the International Monetary Fund?* (last modified Sept. 1998) <http://www.imf.org/external/pubs/ft/exrp/what.htm>.

139. *See* Taylor & Gregg, *Brazil: Brazil Effectively Devalues Currency; Action Creates Widespread Concerns*, *supra* note 102; David E. Sanger, *Brazil Bailout: 2 Gambles for U.S.*, N.Y. TIMES, Nov. 14, 1998, at A4. The United States offered $5 billion for this plan. *See* Taylor & Gregg, *Brazil: Brazil Effectively Devalues Currency; Action Creates Widespread Concerns*, *supra* note 102.

140. The World Bank is similar to the I.M.F, but has a slightly different purpose. *See* David E. Driscoll, *The IMF and the World Bank, How Do They Differ?* (last modified Aug. 1998) <http://www.imf.org/external/pubs/ft/exrp/differ/differ.htm>. The World Bank's sole purpose is "to promote economic and social progress in developing countries by helping to raise productivity so that their people may live a better and fuller life." *Id.*

141. The Inter-American Development Bank conducts research and maintains records on the economy of Latin American and Caribbean nations. *See Inter-American Development Bank* (1999) (visited Jan. 7, 1999) <http://www.iadb.org/exr/ENGLISH/RESEARCH_DATA/research_data.htm>. The bank also sponsors a lending program to the nations of the region. *See id.* Founded in 1959, one of the IDB's policy initiatives is the support of the economic integration of Latin American and the Caribbean. *See id.*

142. *See* Larry Rohter, *IMF Announce a $41.5 Billion Rescue Package for Brazil*, N.Y. TIMES, Nov. 14, 1998, at A4.

143. *See id.*

144. James R. Kraus, *IMF Says It Is Arranging Standby Credit for Brazil, with Bank Participation*, AM. BANKER, Oct. 9, 1998, at 20; Schemo, *supra* note 91, at C1. Florencia Deteresa of Global Emerging Markets said, "currency outflows will come down once it's sure that Brazilian foreign reserves will be backed by some kind of overdraft protection from the IMF" *Id.*

The IMF loan is contingent, however, upon having economic reforms in place to strengthen and stabilize the economy.[145] When a reform plan was announced in the fall of 1998, both the IMF and United States Treasury Secretary, Robert E. Rubin, expressed confidence in its ability to bolster international support for Brazil.[146] Brazil's beginning steps toward implementing a plan was enough for the IMF to declare trust in the country's commitment to reform.[147] In November, Michael Camdessus, managing director of the IMF, applauded Brazil for not delaying implementation of remedial action.[148] Rubin concurred with Camdessus, emphasizing that the package should restore investor confidence in Brazil, and that this situation was "a totally noncomparable situation to Russia." [149]

The actions that Brazil must take in accordance with IMF reforms include providing continuing disclosures to lending nations as to Brazil's ongoing financial status.[150] IMF loans also require maintenance of open markets and avoidance of restrictions on trade and government-directed lending or subsidies.[151] In addition, Brazil must lower its budget by $20 billion this year.[152] If Brazil can make the required reforms, it will be able to access the balance of the IMF funds.[153]

President Cardoso, re-elected in October 1998, has remained committed to stabilization,[154] and has pushed for compliance with IMF conditions.[155] In late October of 1998, Cardoso announced an

145. Kraus, *IMF Says It Is Arranging Standby Credit for Brazil, with Bank Participation*, *supra* note 144, at 20.

146. *See* Diana I. Gregg, *Brazil: In Prelude to Aid Package, IMF, Rubin Welcome Brazil Fiscal Stabilization Plan*, BNA INT'L BUS. & FIN. DAILY, Oct. 30, 1998, *available in* LEXIS, News Library, BNAIBF File.

147. *See* Diana I. Gregg, *G-7: Crisis Not Over, But Easing, IMF Chief Says, Lauding G-7 Policy, Latin American Resolve*, BNA INT'L BUS. & FIN. DAILY, Nov. 10, 1998, *available in* LEXIS, News Library, BNAIBF File.

148. *See id.*

149. Paul Blustein, *US, IMF Announce Plan to Avert Brazilian Crisis; Loan Package Totals $41.5 Billion*, WASH. POST, Nov. 14, 1998, at A12.

150. *See* McInerney & Felsenthal, *supra* note 92.

151. *See id.*

152. *See* Taylor & Gregg, *Brazil: Markets Transfixed by Brazil Fight to Stabilize Currency, Stanch Capital Flight supra* note 32.

153. *See* Sanger, *supra* note 139, at A4; Blustein, *supra* note 149, at A12.

154. *See Man of the Year*, *supra* note 29.

155. *See* Schemo, *supra* note 91, at C1.

austerity plan that includes tax increases and spending cuts that total $23.5 billion for 1999.[156] Long-term goals of the IMF plan announced in November include decreasing the budget deficit to less than 5% of the gross domestic product[157] and bringing the federal budget into a surplus.[158] Under the terms of the agreement with the IMF, Cardoso's total spending cuts and tax increases will total $84 billion.[159]

These reforms, however, cannot be expected to be implemented overnight. Brazil faces a protracted recession, which undoubtedly will be painful for its people. Consequently, Brazil's decision-makers will face political pressure and will have to balance IMF demands with concerns for domestic tranquility.[160] Accordingly, the global financial community should be prepared for the delays and frustrations that inevitably accompany such epochal reforms.

V. REGULATORY FRAMEWORK

The risks associated with lending in the emerging markets raises questions about the supervision of United States banking activities abroad. The Federal Reserve Board (FRB) has the principal role of regulating both national and state-chartered member banks that do business overseas.[161] Initially, member banks must obtain FRB approval in order to establish a branch in a foreign country.[162] Along with the Office of the Comptroller of the Currency (OCC),[163] and the Federal Deposit Insurance Corporation (FDIC),[164] the FRB regulates by investigating banks' methods of risk management in their lending

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156. *See* Gregg, *Brazil: In Prelude to Aid Package, IMF, Rubin Welcome Brazil Fiscal Stabilization Plan*, *supra* note 146.

157. *See* Ed Taylor, *Brazil: Brazil's Draft Economic Stabilization Plan Draws Immediate Criticism from Businesses*, BNA INT'L BUS. & FIN. DAILY, Nov. 2, 1998, *available in* LEXIS, News Library, BNAIBF File. Critics say that the plan will weigh too heavily on the private business sector, and does not concentrate enough on tax reform. *See id.*

158. *See* Rohter, *supra* note 148, at A4.

159. *See id.* The spending cuts will reduce Brazil's new debt acquisition and the tax increases will ensure that Brazil can meet its current debt payments. *See id.*

160. *See Brazil on the Slide*, ECONOMIST, Jan. 19, 1999, at 65.

161. *See* JONATHAN R. MACEY & GEOFFREY P. MILLER, BANKING LAW & REGULATION 698-99 (2d ed. 1997).

162. *See id.* at 699.

163. *See infra* notes 165-170 and accompanying text.

164. *See infra* note 165.

policies.[165] Much of the oversight involves making sure that banks have risk management and evaluation procedures in place.[166]

Since the 1960s, the OCC[167] has sent its regulatory inspectors to the foreign branches of national banks for review.[168] In 1977, it began writing the Country Exposure Report, now fully adopted by all three banking agencies under the direction of the Federal Financial Institutions Examination Committee.[169] As a result of the debt crises of the 1980s, the OCC strengthened its supervisory procedures for United States banking activities abroad.[170] The enhanced oversight and risk management procedures included an improvement in the methodology of evaluating country risk, the requirement of disclosure of all foreign banking activities, and the mandate of holding reserves against loans to countries with poor debt repayment records.[171] Furthermore, the OCC began to coordinate more fully with foreign bank supervisors and the IMF.[172]

Concerns about lending practices to particular foreign countries led Congress to pass the International Lending Supervision Act of 1983 (ILSA).[173] The stated policy of ILSA is "to assure that the economic health and stability of the United States and the other nations of the world shall not be adversely affected or threatened in the future by imprudent lending practices or inadequate supervision."[174] Federal agencies are required to establish supervisory procedures to ensure that in the assessment of a bank's capital, such details as

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165. *See* Note, *The Policies Behind Lending Limits: An Argument for a Uniform Country Exposure Ceiling*, 99 HARV. L. REV. 430, 438 (1985).

166. *See* Jerry W. Markham, *"Confederate Bonds," "General Custer," and the Regulation of Derivative Financial Instruments*, 25 SETON HALL L. REV. 1, 37 n.154 (1994).

167. *See* Helen A. Garten, *Regulatory Growing Pains: A Perspective on Bank Regulation in a Deregulatory Age*, 57 FORDHAM L. REV. 501, 550 n.281 (1989). The OCC has the responsibility of overseeing national banks and their subsidiaries; the FRB and the FDIC have the responsibility of overseeing state-chartered banks. *See id.*

168. *See Conover Statement*, *supra* note 3; *see also Hearings on the LDC Debt Crisis before the House Committee on Banking Finance and Urban Affairs*, 101st Congress 299 (1989) (statement of Robert L. Clarke, Comptroller of the Currency).

169. *See Conover Statement*, *supra* note 3, at 273.

170. *See id.*

171. *See id.* at 280.

172. *See id.*

173. *See* 12 U.S.C. § 3901-3912 (1994) (codifying ILSA).

174. *Id.* at § 3901.

foreign country exposure and transfer risk are taken into account.[175] ILSA authorizes federal bank regulators to require that banks maintain reserves if there is evidence that its borrowers may be unable to meet their debt obligations.[176] Furthermore, ILSA provides that if a bank charges a fee in excess of the administrative costs of restructuring the loan, the bank must amortize the fee over the effective life of the loan.[177] Notably, ILSA does not establish specific limitations on United States banks regarding the nature and extent of their activities abroad.[178]

The increasingly global nature of the banking industry and the nature of its associated risks have prompted greater cooperation among supervisory agencies worldwide.[179] To promote worldwide banking standards, the Basel Committee developed Core Principles for Effective Banking Supervision, a set of 25 principles for securing an operating supervisory system.[180] Such action was taken in response to banking system deficiencies in the mid-1990s.[181] Former Comptroller of the Currency, Eugene Ludwig, also advocated the worldwide adoption of the Basel Committee Core Principles, to lend consistency to the market.[182] The OCC has allied itself fully with the Basel Committee on Banking Supervision,[183] whose mandate includes

175. *See id.* § 3903(b).

176. *See id.* § 3904(a)(1)(A)-(B). *See also* Keith A. Palzer, *Comment: Relational Contract Theory and Sovereign Debt*, 8 J. INT'L L. BUS. 727, 742-43 (1988) (discussing the methods of the federal regulatory system).

177. *See* 12 U.S.C. § 3905(a)(1). The stated purpose of this section is to avert excessive debt service burdens on the debtor country. *See id.*

178. *See* Note, *The Policies Behind Lending Limits: An Argument for a Uniform Country Exposure Ceiling*, 99 HARV. L. REV. 430, 440 n.39 (1985) (describing the limited functions of ILSA).

179. *See Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Institute of International Bankers, on International Banking, Washington, D.C., March 2, 1998*, 17-2 OCC Q.J. 51 (1998) [hereinafter *Ludwig Statement*].

180. *See Hearing on Current and Future Bank Examination and Supervision Systems before the Subcommittee on Financial Institutions and Consumer Credit of the U.S. House Committee on Banking and Financial Services*, 105th Congress 92, 105 (1997) [hereinafter *Hearing on Future Bank Supervision*] (statement of Eugene A. Ludwig, Comptroller of the Currency).

181. *See id.*

182. *See Ludwig Statement*, *supra* note 179, at 51.

183. *See* Kristin Leigh Case, *The Daiwa Wake-Up Call: The Need for International Standards for Banking Supervision*, 26 GA. J. INT'L & COMP. L. 215, 221 (1996) (discussing the benefits of having a coordinated international system of banking supervision). In 1974, the Basel Committee was created by the Group of Ten countries. The Basel Committee is made up of supervisors from twelve countries and seeks to

strengthening the quality of supervision of bank's foreign activities through strict disclosure requirements, improved oversight procedures, and prescribed risk management standards.[184]

In 1998, the Asian and Russian crises awakened the United States banking industry to the potential risks arising from international banking.[185] These crises have highlighted the need for greater disclosure of information and the need for international standards of banking supervision.[186] While federal agencies can do their part by regulating the foreign activities of United States banks, the cooperation of all nations in constructing global safety and soundness mechanisms is needed in order to avert future bouts of global financial instability.

VI. CONCLUSION

Involvement in an emerging market is a risky endeavor for the American business community, but is also one with potentially sizable returns. Businesses are crossing over into a relatively uncharted territory when they invest in an emerging market. Unlike the United States, these markets often have weak economies because they lack the necessary infrastructure to sustain volatile market pressures. The recent injection of foreign capital into such markets, however, may help to strengthen these infrastructures, so long as the accompanying debt burdens do not become too weighty. The United States has a vested interest in helping to create economically strong neighbors who can maintain a strong trade relationship.

Banks should consider the consequences of drastically reducing their investments in Brazil and other emerging economies. Despite the fears of inflation and massive capital flight, many analysts are optimistic about the long-term growth of Brazil.[187] The effects of

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standardize banking laws between those countries by providing policy guidance. *See id* The countries included in the committee are Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. *See* Joel P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 COLUM. J. TRANSNAT'L L. 37, 43 n.7 (1995) (describing the functions of the Basel Committee).

184. *See Hearing on Future Bank Supervision, supra* note 180, at 105.

185. *See Ludwig Statement, supra* note 179, at 51.

186. *See id.*

187. *See, e.g.*, Richard Waters, *How Immune is Wall Street*, FIN. TIMES (London), Jan. 15, 1999, at 17, *available in* LEXIS, Market Library, PROPT File (stating that Wall

devaluation, though severe, may be the necessary medicine to cure the country's economic woes.[188] The world should take notice that Brazil has demonstrated its continued commitment to economic stabilization and reform. The IMF loan and the reforms that are conditioned upon it indicate that, despite the turbulence from the blustery winds of global financial markets contagion, there is hope for a stable economic future for Brazil and other emerging economies.

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Street analysts believe Brazil is different from other emerging nations and will be able to limit the negative impact of devaluation).

188. *See* Diana I. Gregg, *Brazil: IMF Pleased With Brazilian Meeting, Emphasizing Keeping Lid on Inflation*, BNA INT'L BUS. & FIN. DAILY, Jan. 20, 1999, *available* in LEXIS, News Library, BNAIBF File. The IMF and the World Bank expressed their support for the government's decision to float the real. *See id.* The anti-inflation program depleted the country's reserves to dangerously low levels. *See id.*