New monetarist scheme to stem collapse of Argentina's economy

by Peter Rush and Cynthia Rush

After less than six months in power, the administration of Argentine President Carlos Menem is facing a worse economic and financial crisis than that which it confronted when it took over from social democrat Raúl Alfonsín last July. Prices were rising so rapidly as of Jan. 2 that many retailers refused to even sell their goods for fear they wouldn't be able to replace them except at a steep loss, while the currency, the austral, threatened to go into an unstoppable free fall in value. Inflation for December was thought to have been at least 140%, and possibly as high as 200% or more.

In a desperate move, on Dec. 30 the Peronist government embarked on a savagely monetarist economic program, misnamed the "Lazarus Plan," in an attempt to stem inflation and bolster the value of the austral. Judging from the contents of the plan, and the fact that its architects are avowed monetarists—Foreign Minister Domingo Cavallo and foreign debt adviser Alvaro Alsogaray—Argentina's near-term future will be one of deeper economic depression. The role of the Bush administration in shaping Argentina's economic policy also merits close scrutiny.

Recent weeks of the Menem administration have been characterized by extraordinary policy disarray. Finance Minister Nestor Rapanelli resigned Dec. 15 after failing to slow the fall of the austral with a sharp devaluation. His replacement, Antonio Ermán González, immediately freed all prices, eliminated all controls on the exchange rate of the austral, and permitted interest rates to rise "freely"—which they promptly did. Rates of up to 600% a month were registered by the end of December.

When these measures not only failed to stem the flight from the austral, but amplified it, reports circulated on Dec. 29 that the government intended to announce a plan to "dollarize" the economy, including the creation of a new currency tied to the dollar, signifying a large devaluation, imposition of harsh new austerity measures, and increased public utility rates. Economic Management Secretary Eduardo Curia was the author of the plan, but he, too, was forced to resign on Jan. 1 reportedly over presidential anger that the plan had been leaked to the media.

Menem told the nation on Dec. 31 that such a plan to "dollarize" the economy had never been contemplated, making Curia look like a liar. But according to the Jan. 4 edition of the Buenos Aires daily *Clarín*, Curia's plan was thrown out only after Finance Minister Ermán met with U.S. Ambassador Terence Todman on Dec. 29, and learned that the Bush administration would not back such a scheme. Todman also reportedly alluded to Argentina's criticisms of the U.S. invasion of Panama, as a further reason for not backing the proposed measures. Todman had made clear to Menem that the United States was displeased with the government's condemnation of the invasion.

Taking the side of the United States, it was Foreign Minister Cavallo and Alvaro Alsogaray who argued in cabinet meetings that the "dollarization" plan shouldn't be attempted, and who are now the most outspoken promoters of the new plan, claiming that this is the way to put Argentina's "house in order." Alsogaray is a follower of the Austrian quack economist Friedrich von Hayek while the ambitious Cavallo, who covets his new post, is a protégé of Rudiger Dornbusch, resident economist at the Massachusetts Institute of Technology. Cavallo traveled back and forth with Menem over the New Year's weekend, in the President's private plane. Alsogaray, the man who helped to overthrow Juan Perón in 1955, went on national television to defend the new plan.

'Australs will become scarce'

What is the "Lazarus Plan"? Ermán González announced the details in a nationwide television address on Dec. 30. The program is premised on a scheme that has never been attempted by any government in the 20th century: to make australs so scarce in the country that businesses and private individuals would be compelled to pay U.S. dollars for them in order to meet legal obligations such as taxes.

The idea behind the new plan is to halt government printing of money to pay exorbitantly high, short-term interest rates on fixed-term deposits and on internal public debt, while forcing the private sector of the economy to pay the government in australs. This is supposed to so limit the supply of australs that people will literally be bidding for them, forcing up their price as measured in dollars, and supposedly rolling back the recent round of price increases. Ermán told the country in his televised address that the austral "would cease to be the instrument of our self-destruction."

The plan eliminates at a single stroke the so-called *plazos fijos*, short-term deposits that millions of Argentine citizens, and even many large businesses, have become dependent on in times of rapidly rising prices, to try to stay ahead of inflation. Henceforth, instead of being paid in australs at up to 600% a month interest—australs which the government has been reduced to just printing—Ermán González announced that interest and principal on these deposits would be paid not in cash at all, but in Argentine government dollar-denominated bonds called "External Bonds," or Bonex. The interest rates on the Bonex are in line with international interest rates for U.S. dollar deposits.

The same substitution has been decreed for fixed-term government bonds constituting much of the nation's internal debt. Many commentators noted that the Bonex will become a virtual parallel currency, and analysts are referring to the "Bonexization" of the economy. The measure is reminiscent of a similar one adopted by Ermán when he was in charge of finances for the province of La Rioja under then-governor Menem, and issued provincial bonds that functioned in place of currency.

According to the new plan, investors will be permitted to withdraw no more than 1 million australs in cash—the equivalent of about $500—and companies dependent on australs for meeting their payrolls will be permitted to receive enough for this purpose. But any individual or business found abusing or cheating on the new regulations, will be hit with the full force of the law, Ermán announced.

A second set of measures is designed to force companies to spend U.S. dollars they have been hoarding, and buy australs. Ermán announced that henceforth, companies will be compelled to pay their full assessed tax burden, in australs, on time, or face being seized by the government and sold off—the "privatization of private companies," as Ermán put it—to pay the obligations.

The finance minister advised Argentines that australs "are going to be very scare and valuable. Be careful. Don't be pressured into spending them. Wait until prices return to the levels they had before Christmas, because the increases in the past week are totally unjustified and the fruit of a type of collective hysteria," he said.

It is reported that in the first day after the measures were implemented, Jan. 4, retailers did sharply lower their prices, and the austral-dollar exchange rate did return to pre-Christmas levels of around 1,200. But other consequences of the measures may make these gains very short-lived.

More recession?

By Jan. 5, the announced measures had led to a 50.3% revaluation of the austral and a drop in some consumer prices, just as the government had predicted they would. Just a few days earlier, many storeowners had refused to sell their wares, for fear that by the time they reordered their products, the price would have risen so far that the store would take a severe loss on the item. Many pharmacies, in particular, were reported to be unwilling to sell drugs, even in cases of medical emergency.

But many economists are already warning that the Argentine economy is very close to full collapse, despite these initial "successes."

The new measures have provoked reactions of panic and anger in a broad stratum of the population suddenly denied the use of most of their money. "Credit has all but dried up," economist Enrique Szewach told Reuters news service. "The question is whether the Central Bank will ease its restrictions to help banks." One European banker reported that businesses that had placed large amounts of money in short-term deposits were now left holding the Bonex bonds, and could be forced to default on their payments. Daniel Muchnik, chief economics columnist for the daily *Clarín*, pointed out that the plan was tantamount to dollarization, and that this would worsen the standard of living of a broad spectrum of the population. "Everything indicates recession," he wrote Jan. 3. Economist Roberto Frenkel predicted "a brutal recession."

Others are pointedly asking how the government, or the private sector, intends to pay the 30,000 austral ($15) bonus promised the workforce. And it is entirely unclear how retailers will pay their suppliers for goods to restock their stores. Still others are questioning the legality of the measures, and anticipate immediate court challenges to the package.

Organizations of independent economists warn that the measures will provoke a general collapse of the banking and retail trade systems, reports Brazil's *O Globo* Jan. 4. Bank depositors will lose all incentives to deposit funds in banks. They also predict that the chain of supply from manufacturer to wholesaler to retailer is threatened with breakdown as companies will lack the australs to pay. "Heterodox economists call the measures crazy" and doubt they can even be applied, *O Globo* reports.

Another question mark is how the government will keep the Bonex from losing value, as the government obligates itself for billions of U.S. dollars that it doesn't have. Argentina's U.S. dollar reserves are currently at only $880 million, Ermán announced. The minister stated that he is seeking several billions in U.S. dollar loans to back up the plan, but that is a very doubtful prospect at present. Ermán is seeking a bridge loan from the United States, but, as the *Wall Street Journal* observed, "there is almost an inertia in Washington about Argentina." The International Monetary Fund has a team in the country now and is reported to be very upset with the government's economic performance.

Menem meanwhile has made clear that he will admit no public criticisms of his economic plan, either from anyone inside the government, or from the Peronist party. "This is the government plan, and whoever wants to criticize it or is in disagreement with it should submit his resignation," he told his cabinet.