Argentina: Next on the chopping block?

by Cynthia Rush

In the aftermath of the Dec. 20, 1994 devaluation of the Mexican peso and the ensuing crisis throughout the Ibero-American continent, Argentine Finance Minister Domingo Cavallo and President Carlos Saúl Menem frantically repeated that "Argentina is not Mexico," and vowed that there would never be a devaluation of the Argentine peso. Shaken by a dramatic plunge in the Buenos Aires stock market—29% since Dec. 20—a sharp decline in the value of Argentine debt bonds including Brady bonds, and a full-fledged banking crisis, Cavallo hauled out detailed graphs and statistics to establish the "differences" between the two nations' economies and pleaded with foreign investors to show confidence in his economic program by not withdrawing their funds.

But the only thing that distinguishes Argentina from Mexico is that Argentina is, if anything, in a *much worse* situation than Mexico was before the devaluation, and, as numerous Wall Street analysts and economists have warned, it is likely to be the next country to explode. Cavallo has not only copied every wrong thing that Mexico has done, but, as Menem likes to boast, has done it twice as fast as Mexico did under President Carlos Salinas de Gortari. This should surprise no one. Domingo Cavallo and the former Mexican finance minister responsible for the current debacle, Pedro Aspe, go back many years together, to their days as students in Boston—Cavallo at Harvard and Aspe at MIT—where they became good friends. Before Cavallo became Argentina's finance minister, he used to sit in on Aspe's meetings with his economics team to learn about the Mexican "economic miracle."

Not only do these two share a commitment to the free-market lunacies they have each imposed on their nations, but they also share an intimate friendship with David Mulford, U.S. Treasury undersecretary under George Bush and now an executive at Crédit Suisse First Boston, who has served as adviser and mentor to both men. Architect of the infamous Brady debt reduction plan which is now being shredded under their noses, Mulford is currently coordinating Cavallo's dealings with the Wall Street banking community and has launched a "Vamos Argentina" ("Let's Go Argentina") publicity campaign to sell the virtues of Cavallo's plan to save his model in 1995. As Brazilian journalist Carlos Chagas recently wrote in the daily *Tribuna da Imprensa,* in a play on words with Cavallo's name which means "horse" in Portuguese: "Argentina is headed, on horseback [a Cavallo], over the same cliff [as Mexico]."

But no amount of publicity will prevent Argentina from blowing up. Now it is only a question of when, not whether, the explosion will occur.

There is no national currency

Two factors suggest that the blowout could occur soon. One is the fact that since March 1991, the Argentine peso has been pegged by law to the U.S. dollar in a one-to-one parity—Cavallo's famous Convertibility Plan. By prohibiting the central bank from issuing new money unless it is backed by gold or dollar reserves, this dollarization plan took credit generation out of the government's sovereign control and handed it over to the U.S. Federal Reserve, making the peso a "sick man" and the dollar virtually legal tender inside the country. The lines of citizens standing outside the country's banks today anxiously waiting to trade in their pesos for dollars is not only a testimony to the completeness of the dollarization scheme, but of the fact that average citizens still don't believe Cavallo's claims that the peso is "as good as the dollar."

As the daily *Clarín* accurately put it in November 1992, the Cavallo model meant that domestic economic policy, particularly the quantity of money in circulation as well as interest rates, "would depend fundamentally on international fluctuations and the policies adopted *outside the country.*" Lawfully, because the fixed-parity system offered little risk to foreigners, the country has also become a playground for speculative stock market and derivatives-related "investments," replacing normal banking and other economic activities related to production. Argentina has the dubious distinction of entering the "post-industrial" era without ever having fully developed its own industry! Entirely dependent on foreign capital flows into the country, the model—and the country's ability to sustain its $8 to $10 billion current account deficit, included in which is its debt service bill—collapses when the capital begins to flee as it is now doing. This is a carbon copy of the formula for the Mexico debacle.

Secondly, privatization—the selloff of the public sector demanded by foreign usurers—is not an option for Argentina the way it still is for Mexico and especially Brazil. The Menem government has *already* sold off "Grandma's jewels" in such crucial companies as the formerly state-owned oil company Yacimientos Petrolíferos Fiscales (YPF) and a large number of other state-owned companies, generating a cumulative total of $20.5 billion. Cavallo announced on Jan. 9 that he is now prepared to sell off all remaining state assets, including the strategically vital National Atomic Energy Commission (CNEA), the Yaciretá and Salto Grande dams, the Bahía Blanca petrochemical complex, and the Futaleufú and Pichi Picún Leufú and a number of smaller hydroelectric and energy-generating projects. He even sweetened the offer with a debt-for-equity plan permitting Argentina's depreciated debt bonds to be used to pay for 100% of the value of stock in the privatized companies, whereas previously they could be used only to pay for a portion of the total. However,

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Finance Minister Domingo Cavallo's name has become synonymous with the destruction of the economy, on Wall Street's orders.

the total of these sales is not likely to exceed $3 billion, if that.

The cow has no milk

The finance minister argues that what is happening in Argentina today is just a "summer storm," rather than a reflection of the insanity of his precious model and the rottenness of the whole international financial system. So, in his Jan. 10 meeting before 200 investors and bankers at the St. Regis Hotel in Manhattan, Cavallo hysterically promised to "deepen" the model, promising that "if we find any regulation which distinguishes pesos from dollars, we shall eliminate it." On Jan. 11, through Decree 22638, that is precisely what the government did, among other things, allowing banks to hold reserve ratios either in pesos or dollars.

He vowed that the government would demonstrate that it merited investor confidence by generating a $3 billion surplus in 1995, by "implacably" reducing government spending, slashing what remains of the state sector, increasing tax revenues, and coming up with a balanced budget for 1995. The 1995 debt service bill of $5.2 billion (in amortization and interest) will be met by issuing at least another $5 billion in dollar-denominated debt paper and using revenues from privatization.

In a worst-case scenario, the economy would grow by 4.5%, he said, and by 6% under better conditions. The trade deficit will not exceed $4.7 billion in the more negative scenario and $1.5 billion in a positive one; exports will increase by 20% and imports by 10%. If more austerity is ruthlessly imposed, he argued, Argentina can survive.

Cavallo's projections are illusory, for two reasons: Argentina is already in a deep recession, as a result of the last several years of neo-liberal reforms, and its population and what remains of the productive sector will not sustain, either economically or politically, the brutal austerity that the minister is contemplating. This becomes especially relevant because Argentina's presidential elections will be held in May 1995, and Menem is desperately seeking reelection. Will he really be prepared to kill off retirees by further reducing the payments they are owed by the government? Will he risk social explosion in the provinces especially?

Official unemployment already stands at 12% and underemployment at 10%—more than 20% of the economically active population, or 2.8 million people. Most telling in this rich agricultural nation is the fact that the consumption of beef, a staple of the national diet, had dropped from 68 kg per capita in October 1993 to 62.8 kg one year later—a decline of 7.7%. Overall, the agricultural sector, traditionally the source of Argentina's export revenues, is in crisis, unable to obtain parity prices for its products. At least 40,000 small and medium-sized companies are on the brink of bankruptcy; regional economies, subjected to a domestic austerity regime, are devastated. Several state banks, such as those in San Juan and Córdoba, are bordering on insolvency.

As one member of Cavallo's own team bluntly told *Noticias* magazine, "If capital inflow slows down, the danger isn't devaluation, but recession."

A September 1994 report produced by the Argentine Industrial Union (UIA) included some alarming numbers on the state of national industry. Currently, the capital goods sector uses only 26% of installed capacity; over a one-year period, exports of machine-tools dropped 38% and imports increased by 132%. Exports of agricultural machinery dropped to one-tenth of what they had been. Tractor production has dropped from 12,322 units in 1984 to 2,916 in 1993, of which 42 were sold abroad. Production of railroad machinery has all but ceased, as has ship production. Several other sectors have stopped production to dedicate themselves to imports. "Fifteen 'uncompetitive' petrochemical plants have closed their doors forever, tossing out 30% of their workforces in the process," the UIA document reports.

The banking system is sinking

Add to this the reality that *the Argentine banking system is insolvent*. Best reflecting the insanity of the speculative cancer which has taken ahold of these nations' economies, banks no longer lend money for productive investment but make their profits in the "bicycle" of trading in bonds and debt paper as well as leveraging and other derivatives operations, relying on foreign capital to do so. What credit is available is prohibitively high at 20 to 25% interest rates, for smaller banks and enterprises as well as individuals.

The Banco Extrader, one of two banks and two brokerage houses which have entered into bankruptcy reorganization in the last few weeks, handled 7% of the national market in debt paper. It also reportedly engaged in questionable offshore practices in the Cayman Islands as well as leveraged speculative operations. Its total losses were $70 million.

The newpaper *El Cronista* reported on Jan. 6 that the banking crisis really began, not in December 1994, but in the middle of the year, when it became more difficult to get foreign financing; once the Mexican crisis hit, and depositors began to withdraw their funds or move into dollars, the ensuing bank run threatened the existence of many smaller banks. The second bank to go under, Banco Finansur, lost half of its deposits, $45 million, in just two weeks.

According to *El Cronista,* the "irregular"—or problematic—debt held by the entire banking system increased from 45% of its patrimony in January 1994 to 58% in August. In the 12-month period between September 1993 and 1994, loans at risk of default increased by 25%. According to a new banking law which was scheduled to go into effect on Jan. 1, banks are being asked to increase their reserves against loan defaults.

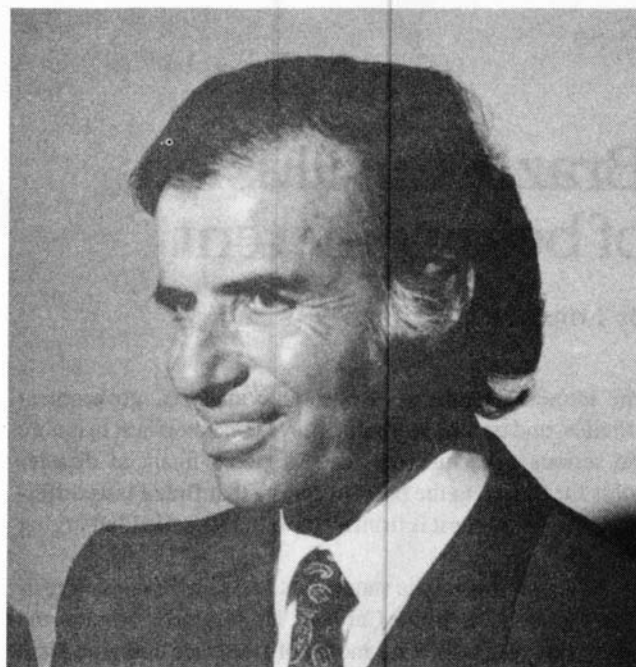
The much-publicized "safety net" originally set up by five large banks and then broadened to include several more, is, according to many reports, non-functional. The central bank was to have allowed the large private banks to lower their reserve ratios on the condition that these funds be re-lent to banks with liquidity problems. But according to Finansur executive Marcelo Ruíz Huidrobo, in his bank's case, the safety net couldn't respond with the speed required by the run on the banks. Others have complained that the process is extremely selective—that only banks with good chances of repaying the loans are receiving assistance.

As of Jan. 12, the central bank announced a reduction of bank reserve ratios in a desperate measure to inject $1.5 billion in liquidity into the system.

And the foreign debt?

As one astute local commentator noted, the Achilles' heel of Cavallo's model is the foreign debt. A series of negative factors adds up to an inability to sustain the current account deficit. Foreign funds are drying up; the cost of foreign loans are increasing because of higher international interest rates; there will be an increasing difficulty to find buyers for Argentine debt paper. Setting domestic interest rates high to attract foreign capital courts disaster.

As *EIR* noted in its May 1994 study on the Ibero-American debt blowout, Argentina's *real* foreign debt at the end of 1993 was $106 billion, much higher than the official figure of $70 billion. This is due to the category we described as "internationalized internal debt"—the nominally domestic or internal debt which really constitutes a *foreign obligation* because it is denominated in U.S. dollars. This "internal debt" actually functions as if it were a foreign debt, in that it can flee the country at a moment's notice.



Argentine President Carlos Menem, who is facing a re-election campaign, is at pains to insist that "Argentina is not Mexico."

At the end of 1993, that figure stood at an estimated $33 billion—$14 billion of it public and $19 billion of it private, denominated in dollars, plus another $3 billion in foreign-held peso-denominated debt. Today, that figure has risen significantly, although exact data is unavailable. It is likely that the total real foreign debt of Argentina at the end of 1994 was in the range of $125 billion.

The trend of flooding the country with foreign imports has continued to increase, in line with Cavallo's "economic opening." The estimated 1994 trade deficit is $5.8 billion, almost double 1993's $3.5 billion figure. Exports were $19.1 billion and imports $25.9 billion, the latter a jump from 1993's $16.8 billion.

Projected 1995 debt service, including amortization and interest is $5.2 billion; how will it be paid? Cavallo intends to issue at least $5 billion in debt bonds on the international markets. In 1994, $3.7 billion of debt paper was placed on the markets, in order to cover $2.9 billion in debt service. In the last 70 days of 1994, the government issued $2.8 billion worth of bonds, $1 billion of it in the first two weeks of December. The suspicion is that this latter issuance was to cover a fiscal deficit much higher than what the government was admitting to. Last October, the Federal Tax Commission revealed that the finance minister had delved into the nation's pension funds to cover a Treasury deficit.

This all adds up to a formula for financial explosion and economic catastrophe—and political defeat of Menem in the upcoming elections.