Argentina: Convertibility plan is 'virtual reality'

by Gerardo Terán Canal

U.S. Secretary of State Warren Christopher caused quite a stir among Argentina's political and social circles when he said during his late-February trip to the country that Finance Minister Domingo Cavallo "is a hero in the United States . . . because together with President [Carlos] Menem, he has promoted the economy and transformed this country. . . . He has made Argentina one of the big economic successes, not only of this decade, but of the century." The only thing left for Christopher to do was present Cavallo with the "Order of Wal-Mart," referring to the U.S. discount store at whose local branch Christopher made his remarks.

With his effusive praise of Cavallo, whose performance was being harshly criticized domestically at the time, Christopher was attempting to confirm the international financial community's support for the embattled finance minister. At the time of Christopher's visit, dailies such as the prestigious *Ambito Financiero* blared out the news that industrial activity had fallen 9.3% in January 1996, and that the country was in the midst of a severe economic recession.

Both in Argentina and internationally, the media has prominently covered Cavallo's alleged success in preventing Argentina from being hurt by the "Tequila effect" (i.e., flight capital leaving Ibero-America, as happened after Mexico's 1994 devaluation crisis). A great deal of newsprint was wasted in playing up Argentina's so-called monetary stability, which convinced "international investors," and, initially, Argentines—businessmen as well as the population at large—that this was the policy that would prevent the country from ever returning to the economic and social disasters caused by the hyperinflationary explosions of the 1980s.

Today, tremendous efforts are being made to ram this model, which is based on the British colonial policy of a currency board, down the throats of the rest of Ibero-America's nations, with the lie that they, too, can achieve the "stability" Argentina has. As we shall demonstrate below, that stability is an illusion, based on extraordinary looting of the country's physical economy and human resources. One need only look at who the model's most vociferous backers are, to understand the content of the policy: international speculator George Soros; the Mont Pelerin Society's Steve Hanke, who boasts to whoever will listen, that he is the architect of Argentina's "convertibility plan"; and Harvard University's punk economist Jeffrey Sachs, who repeatedly laments that Argentina's labor force hasn't yet been smashed.

Control over currency issuance

It is useful to examine this convertibility plan in some detail. Implemented in April 1991, the plan was the means by which Argentina relinquished sovereign control over currency issuance. In its place, it established a one-to-one parity between the dollar and the peso, a version of a currency board. Under this system, the only source of currency in circulation, or credit, is foreign credit in dollars which, in large part, both for the public and private sector, is obtained through issuances of bonds which can be negotiated on the local and foreign stock markets. The International Monetary Fund (IMF) is the only source of loans used to cover the fiscal deficit, or defaults on foreign loans, while credit from other multilateral lenders (e.g., the World Bank) is used to finance the structural reform of the State, such as privatizations of public-sector companies.

The other sources of foreign monetary resources are the so-called international investors, who, after buying up entire chunks of Argentina's sizable productive apparatus and State-sector utilities for a song, are now devouring industries, mines, and the fertile lands of the *pampas* at bargain-basement prices. Exemplary is the role of drug-legalization advocate Soros, who has not only spent millions of dollars to purchase Argentine real estate, but has publicly warned the Menem government that no change in policy will be tolerated by the international banking community. In a late-March press conference in Buenos Aires, Soros put out the word that if policy were changed, or Cavallo left office, he would pull all of his money out of Argentina.

Only ten nations in the world have functioning currency boards; Argentina is the only one that does not officially belong to the British Empire.

The bottom line is that sovereign control of credit is prohibited. The only possible source of internal credit then is "domestic savings," which, through use of credit cards and credits in dollars, created a consumer boom during the first three years of the plan, and helped to create the illusion that an era of change and prosperity had finally arrived.

By prohibiting currency issuance, the convertibility plan has prevented the inflationary issuances of the 1980s, which covered large budget deficits. At the same time, however, it has eliminated all national credit for production. As one expert told *EIR*, this process has generated a "hyperinflationary process in reverse." That is, despite supposed monetary stability, the capacity for internal consumption, which to date has been largely dedicated to purchase of imported consumer goods, has been exhausted; national production is collapsing, unemployment is increasing uncontrollably, and foreign debt is growing exponentially. Most of the foreign loans obtained by this government since 1991, have gone to payment of that debt.

Thus, the convertibility plan has generated a typical collapse function, of the type discussed by American economist Lyndon H. LaRouche, Jr., in which monetary and financial aggregates (including debt) grow exponentially, while the physical economy collapses.

Foreign debt explodes

Already in mid-1994, *EIR* had reported that the real foreign debt of Argentina (like that of other Ibero-American countries) was much greater than the official foreign debt (see **Figure 1**). Against the official figure of $71 billion in 1993, *EIR* calculated that the real foreign debt was $31 billion more, that is, $101 billion. By late 1994, the real foreign debt had grown to $111 billion, and by the end of 1995, it was more than $122 billion.

These figures are much higher than those accepted by the World Bank, the Menem government, and various "expert" agencies. What is the difference between these official figures and those arrived at by *EIR?*

• First, there is the foreign public and private debt acknowledged by the World Bank, which, in 1994, was approximately $60 billion for the public debt, and $17.4 for the private debt. To these figures, one must add another $12 billion in public bonds issued internally, but in dollars.

• One must also add the public bonds issued in pesos, which are in the hands of foreigners, and which, with the free convertibility between the peso and the dollar, constitute de facto foreign obligations. It is estimated that in 1993, this equalled some $2.4 billion.

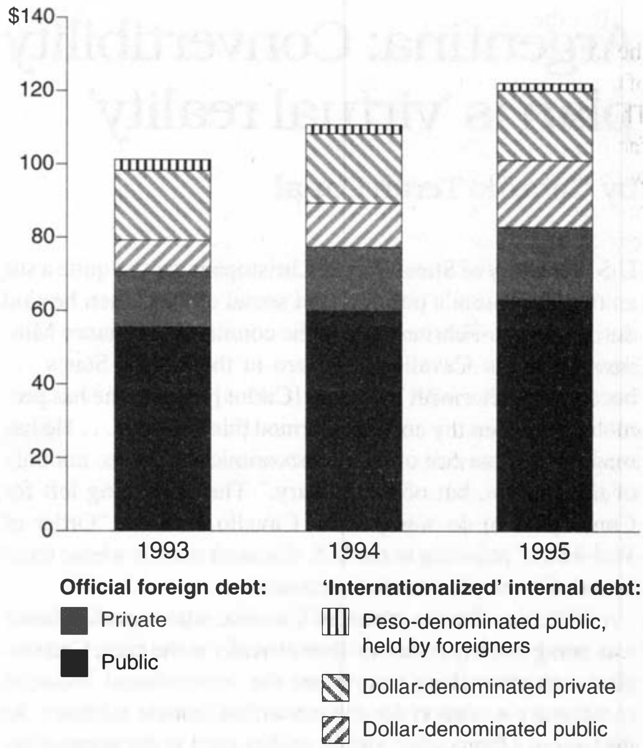
• Finally, one must add the private internal debt in dollars, which, because of convertibility, has been acquired domestically by Argentines through dollar credit cards, dollar bank loans, and similar such means. The total of this category in 1993 was $19 billion. There are no available figures for 1994 and 1995, but we estimate that, minimally, it stands at the 1993 level.

Thus, we arrive at a figure for Argentina's real foreign debt of $110.8 billion for 1994, and of $122.3 billion for 1995. In the five years that Argentina has suffered under its convertibility plan, this real foreign debt has grown approximately 50%, and is today growing at more than 11% per year.

During 1995, the government had to increase its debt by $12.274 billion, and use $10.2 billion of this only to pay off interest and principal due on the public debt. Of the $10.2 billion, $7.224 billion was obtained on the international markets, through new bond issues. In 1995, according to the Buenos Aires daily *Clarín,* Argentina "became Latin America's largest bond issuer." The other $5.5 billion was obtained through IMF and foreign commercial bank loans. This increase in debt occurred despite the fact that "during this period [1991-95], public companies were privatized to the tune of $27 billion, and the debt was reduced through the Brady Plan by $2.3 billion."

Fears of an uncontrolled growth of the debt arise when one takes into account the fact that the Argentine government achieved a good "performance" in placing bonds on the international market, thanks to the "attractive" interest rates offered, some of the highest in the world. According to former

Argentina: real foreign debt
(billions $)



Central Bank President José Luis Machinea, "to the extent that the existing debt matures and is replaced by new debt, service costs will rise considerably, by no less than 60%." These maturities will come due in 1996. Between Brady Bonds and dollar-denominated public bonds, Argentina owed $55.458 billion on Dec. 31, 1995, and another $13 billion on private sector bonds—a bubble of nearly $68 billion for a country of only 33 million inhabitants.

How will Argentina pay?

Whether Argentina can pay its debt, is a real question. In 1995, after two years of a trade deficit, exports grew by 33%, reaching $21 billion and producing a surplus. But, according to the experts, a new deficit is expected in 1996. This means that the debt will continue to grow and the source of foreign exchange to service the debt will shrink.

As of April of this year, the IMF must approve the arrangement it struck with the Menem government for 1995. What the IMF would be approving would be budget expenditures of $50.8 billion, of which $10.8 billion is allocated for servicing the foreign public debt (more than 20%), and $40 billion for government operating costs, which have been reduced by nearly $3 billion over 1994 expenditures. The government promised the Fund it would raise $48 billion in taxes, at $4 billion a month, and that the $2.6 billion deficit would be financed with various privatizations still to be carried out, such as the nuclear plants and the Yacretá hydroelectric project, and with foreign capital.

But the Argentina which can fulfill this agreement with the IMF only exists in virtual reality. With just two months of tax collections in 1996, there is already a $1.1 billion deficit. This, despite the fact that at the end of 1995, the government facilitated a tax moratorium (allowing payment of back taxes without penalties, if they were paid promptly) to increase revenues. And now, the tax collection agency DGI is taking legal action against 1,000 important companies for not having complied with the terms of the moratorium.

The reality is that the Argentine economy is disappearing. The tax base is being crippled at the same rate that the productive economy is being crippled, and if the IMF wants to keep Argentina as its model for the so-called new world order, it will have to keep the country in intensive care, as it has been doing throughout the period of the convertibility plan, lending it yearly more and more money to maintain the image of apparent economic stability, while the international speculators loot the physical economy. Given this reality, one can expect that the real foreign debt will reach $135 billion in 1996. And the moment that this international financial flow is suspended—as sooner or later it will be—is the moment that Argentina will sink into depression.

So, the question comes down to how much oxygen the international financial system has left, and how much guts does Argentina have to resist the shock treatment it received during 1995 and which is expected to worsen in 1996.

Industrial Argentina disappears

According to figures from the National Institute of Census and Statistics (INDEC), Argentina's Gross Domestic Product fell 3% in 1995, and industrial activity shrank by 5%. The newspaper *Página 12* commented that "1995 was marked by a special retraction of internal demand because of the recession; this year, investment, production, and sales will adjust to the country's capacity to grow."

Automobile sales fell 35.5% and production by 30.2% in 1995. During the convertibility euphoria, Finance Minister Cavallo predicted that 800,000 cars would be produced in Argentina in 1995, a gross overestimate; in 1996, only 380,000 will be produced, 25% fewer than last year's roughly half a million. According to the Foundation for Latin American Economic Research, overall industrial activity fell by 9.3% in January 1996. The automobile sector fell 47.5% in that same month, as compared to January 1995; the cement sector fell 26.4%, iron and steel 27.1%, tires 36.5%. All of these are sectors which produce largely for domestic consumption; the only sectors that continue to show growth are those dedicated to export.

Similarly, the Coordinator of Commercial Activity published an analysis last January which revealed that more than 25,000 businesses shut their doors nationwide in 1995.

The logical consequences of this horrifying economic picture were that in May 1995, according to INDEC, Argentina suffered a record unemployment rate of 18.6%, which by December was "reduced" to 16.4% by virtue of the fact that people became tired of looking for jobs that didn't exist, and dropped off the unemployment lists. In a single year, unemployment of nearly 7% was generated. During the most difficult moments of the so-called era of hyperinflation, in the 1980s, the rate of unemployment ranged between 5% and 6%. Unemployed now number 1.98 million, and underemployed another 1.56 million. Only 46% of employees receive stable wages. That is, they pay taxes and the companies which employ them pay taxes for them. The other 54% do not even show up in the tax "pie," nor receive a just wage.

A study by the Foundation for Economic Development Research, published in May 1995, reveals that in Greater Buenos Aires, where the largest urban concentration in the country is located (approximately 12 million inhabitants), nearly 30% of homes—2,227,391 individuals, 800,000 more than last year—receive wages of less than $440 a month, the value of the so-called "subsistence market basket." Fifty-nine percent of homes (5.37 million people) do not make the 987 pesos, or dollars, which constitutes the market basket of food plus other basic goods. This is in Buenos Aires, where unemployment is 17.6%, but the situation is still worse in the industrial and agricultural regions of the country where unemployment exceeds 20%.