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Federal Reserve 'dollarization' scheme will ruin Ibero-America's economy

by Cynthia R. Rush

If Wall Street has its way, the U.S. dollar will soon become the instrument by which nations' sovereign control over their domestic financial systems, the formulation of monetary policy, and most importantly, credit generation, are thrown out the window—*both* in the United States *and* Ibero-America—to be replaced by a supranational bankers' dictatorship. This process is now well advanced in several Ibero-American countries, as national currencies are turned into worthless scrip, and the productive sectors of the economy are looted.

Included in the North American Free Trade Agreement (NAFTA) are secret financial protocols intended, among other things, to incorporate Ibero-America's central banks into the U.S. Federal Reserve System, effectively creating a hemispheric system dominated by a global, *internationalized* dollar (see *EIR*, Oct. 8, 1993).

The International Monetary Fund (IMF) officials who back this plan say the idea is to set up special swap arrangements with these central banks—one already exists with Mexico's central bank. In violation of the U.S. Constitution, the Fed will act as a lender of last resort, generating through its discount window dollar-denominated credit outside the United States. Through the major New York commercial banks, whose operations in Ibero-America have been facilitated by financial deregulation in those countries, this illegal dollar credit generation will be multiplied many times over and feed into the speculative bubbles, including the derivatives market, which are expanding throughout the continent as the physical economy disintegrates.

The replacement of national currencies by the U.S. dollar, began in the mid-1970s, and has been a crucial preparatory phase for this global scheme. The classic case is Panama, whose financial system was incorporated into the Federal Reserve system in 1903, *militarily,* in order to protect U.S. geopolitical and banking interests. Its currency, the balboa, *is* the U.S. dollar.

Then in Uruguay, between 1974 and 1976, a currency reform was carried out which dollarized the economy such that today, the ratio of dollar to peso assets within the financial system is 12 to 1. The 1985 "stabilization" program implemented in Bolivia under the direction of Harvard University's shock therapist Jeffrey Sachs and then-Finance Minister and now President Gonzalo Sánchez de Lozada, also rapidly dollarized that economy. Today, 80% of its bank deposits are in dollars. Since the possession and circulation of dollars was legalized in Cuba in August of this year, authorities there say they fear this will lead to the disappearance of Cuban peso. It is estimated that 10% of all transactions for goods and services are now being conducted in dollars.

The Argentine model

Most recently, the international bankers have lavished praise on Argentina's "convertibility plan," carried out under the direction of Harvard-trained Finance Minister Domingo Cavallo with the approval of President Carlos Menem. Cavallo got a later start than neighbors Bolivia and Uruguay, but since obtaining congressional approval in March 1991 of legislation to peg the Argentine currency to the dollar, he has locked the domestic financial system into the international dollar banking system.

The reform has left Argentina's physical economy in shambles. But that doesn't bother these international bankers. What they like is that Cavallo's reform has made the country a focal point for speculative stock market and derivatives-related "investments" encouraged by the fixed parity which offers little risk to foreigners. In a way similar to, but also more intense than in the 1970s, Argentina has become a lucrative playground for the financial usurers who will take their money and run at the first sign of trouble. While the peso is still used for paying wages and taxes, it is generally referred to as a "sick man." Dollar deposits in the banking system amounted to $14.5 billion in August of this year, as opposed to 11.5 billion in peso deposits.

The original March, 1991 legislation established a fixed parity of one dollar to 10,000 australs, the name of the domestic currency at that time. The legislation prohibited the central bank from issuing new money unless it was backed by gold or dollar reserves. In other words, credit generation inside Argentina was taken out of that country's sovereign control, and handed over to the U.S. Federal Reserve. Subsequently,

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Cavallo removed four zeros from the austral and resuscitated it as the peso, establishing a one-to-one parity with the dollar. That was accompanied by an aggressive tax collection policy and plan to privatize state sector companies at lightning speed.

In the fall of 1992, Cavallo took additional steps to consolidate the convertibility plan. In September, legislation was passed making the Central Bank of the Argentine Republic (BCRA) completely autonomous of Executive branch control, defining its fundamental mission as "preserving the value of the currency." The BCRA president was granted enormous power, to the point that the Sept. 26, 1992 daily *Clarín* commented that "the bank's president could reduce the importance of the finance minister in defining economic policy over the next few years. . . . Managing the money supply will be the primary function of this new central bank, independent of what the finance minister orders."

In November 1992, the central bank's steps to expand dollarization were dramatic enough to cause the financial daily *Ambito Financiero* to ask on Nov. 17, "Will the peso-balboa be born?" New reforms included allowing banks to hold reserve ratios in either pesos or dollars, and legalizing dollar checking accounts. The Nov. 18, 1992 *Clarín* explained that the measures translated into a "greater, explicit dollarization of the economy." Banks would be discouraged from holding peso accounts, and the dollar would circulate more freely in the economy. If the public decided to increase holdings in dollars, banks would have no reason to pay higher interest rates on peso acconts which, Cavallo reasoned, were one of the causes for recession. Banks could also back up their peso loans in dollars, and if there were a lack of liquidity, they could remedy this by borrowing in local or foreign markets.

Put simply, these measures meant that the state would no longer make monetary policy, or, as *Clarín* put it, both the quantity of money in circulation and interest rates "would depend fundamentally on international fluctuations and the policies adopted *outside the country*" (emphasis added). In his 1992 book *País Archipélago,* Daniel Muchnik, *Clarín*'s chief economist, emphasized that the measures really reduced the BCRA's role to a merely technical one of monitoring dollarized commercial or credit transactions carried out with foreign financial entities. "The dollarization mutilated the BCRA, [preventing] it from making any credit or monetary policy. . . . In the long term this implies a loss of economic and monetary sovereignty."

A colonial policy

Even though international bankers see Cavallo's reforms as a success story, some say they don't go far enough because they don't guarantee that the BCRA won't buck these policies sometime in the future. They propose the creation of a currency board, a mechanism long associated with the policies of the British Empire which still exists today in Hong Kong, Singapore, and Brunei. As American economist Steve Hanke argued in a *Wall Street Journal* article in October 1991, the beauty of a currency board is that it makes "monetary populism" impossible. It issues notes and coins which are convertible into a foreign reserve currency at a fixed rate on demand. Its reserves are equal to 100% of its notes and coins in circulation. The board "has no discretionary policy."

Bankers are drooling at the thought of officially forcing Brazil into the dollarization fold. When Finance Minister Fernando Henrique Cardoso returned from this year's annual IMF-World Bank meeting, he was carrying with him a Fund proposal to set up a currency board which would issue a second, dollar-linked currency to function alongside the existing cruzeiro. The Fund officials argue that this is the only way to combat Brazil's 40% monthly inflation rate, and to ensure the necessary austerity policies.

But according to economist Paulo Nogueira Batista Junior, in an interview published in the Sept. 8 *O Estado de São Paulo,* the only thing that dollarization would achieve in Brazil would be to "tie us . . . to the decisions of the U.S. Federal Reserve and Treasury, regardless of the interests of our economy." Moreover, he added, a currency board "is typical of the British colonies prior to World War II. . . . I'm astounded that an entity such as the World Bank recommends that Brazil resolve its inflationary crisis by regressing to the monetary regimes of the British colonies." Nogueira indicated that such a policy would undoubtedly increase dollar inflation—as has occurred in Argentina—and risk a balance of payments crisis as well as a loss of competitiveness in Brazilian exports. "Dollarization could be a dead-end street, even if we succeed in reducing cruzeiro inflation," he warned.

"Neo-liberal ideology has taken on the air of insanity," is how economist María da Conceição Tavares characterized the IMF-World Bank proposal. Not unimportant is the fact that she made these remarks at a seminar at the Superior War College (ESG), some of whose documents in the past have put forward a perspective for Brazil's rapid industrialization, based on rejecting IMF policy. The Anglo-American banking community is extremely nervous about how Brazil's Armed Forces might react in the current, crisis situation. Tavares's comments undoubtedly reflect the sentiments of nationalist military elements.

In the Oct. 7 seminar, she pointedly referred to the plan as "the Hong Kong and Estonia model; it is the end of any national development project. Getting rid of the public deficit isn't good enough. Now the Washington theorists say we have to have a permanent surplus and eliminate the internal debt, something which not even the U.S. has done." Aside from the risk of producing a big trade deficit, which has also happened in Argentina, Tavares warned that the real purpose of the IMF plan "is to sell off state companies at banana republic prices." It is worth remembering, she said, that even U.S. government officials admitted that IMF shock policies were partly responsible for Russia's recent upheaval.