Ibero-America

After Argentina's Default, Who's Next?

by Dennis Small

Nineteen ninety-nine was a turning point in recent developments in foreign financial flows toward Ibero-America. In January-February of that year, Brazil, the largest debtor in the so-called developing sector—with more than $500 billion in real foreign obligations—underwent a major debt crisis, including a maxi-devaluation of its currency, the real.

Bank lending to Ibero-America dried up almost overnight, and has not resumed to date. In its stead, Brazil, Argentina, and Mexico, the region's three major economies, have been driven to issue bonds, but even with that, earlier levels of total foreign financing never returned.

As **Table 1** shows, the bankers' cartel, the Institute of International Finance, expects net private financial flows (1.0) to Ibero-America in 2001 to be only $44.6 billion—less than half the level of 1998—and to drop yet further in 2002 to $42.7 billion. Within this category, loans from private creditors (1.b) have dropped to almost negligible levels, and the only line remaining is that of net direct equity (1.a), often referred to as Foreign Direct Investment, or FDI. In the case of Ibero-America, this consists almost entirely of revenues coming from the privatization of state assets—i.e., not from foreign creation of *new* productive capital in the region, but from fire-sale purchases of *existing* assets. Privatization, by definition, is finite, and will dry up entirely once all the state-owned national assets have been handed over to foreign interests.

Line 2.0 of Table 1 is particularly noteworthy: The bankers' cartel "expects"—i.e., they are demanding—that their pull-out from Ibero-America be covered and financed by $26 billion and $22 billion in "official" flows in 2001 and 2002, respectively. This is the rubric covering International Monetary Fund and Group of Seven governmental bailout packages, which have already been substantial for Argentina, Brazil, and Mexico. There is currently a raging debate in the world financial community as to whether the IMF and G-7 governments will step in, yet again, to bail out Argentina—or rather, to bail out its creditors.

However, these overall Ibero-American numbers actually mask an important distinction within the region: Argentina is currently undergoing a dramatic withdrawal of foreign financial assets, as it is being driven into official default. Under the rubric of "risk aversion," a portion of those assets are being transferred to Mexico and Brazil, *for the moment,* as creditors nervously try to convince themselves that there will not be any Argentine "contagion" of those countries. **Table 2** gives some indication of this process, over the last four quarters.

But "contagion" is unavoidable, starting with Brazil. This is not because Brazil will be "infected" by Argentina in some fashion. It is because both countries are victims of the same global financial disease, the hyperinflationary blow-out which has been under way since the late 1990s. Brazil is particularly vulnerable because of its gigantic real foreign debt, and the fact that, over the last year, it has increasingly covered its foreign financing requirements with public bonds *denominated in dollars*. Such bonds automatically ratchet up the country's total public debt every time there is a devaluation of the Brazilian real—without borrowing a single new penny.

Similar dollar-denominated bonds were the particular trigger that exploded Mexico's debt bubble back in late 1994. Now, Brazil, facing a dramatic shortage of foreign capital with which to roll over its bubble of financial obligations, has constructed the same house of cards that collapsed Mexico. Over the last year, these dollar-denominated bonds grew from about 20% of Brazil's total public debt, to over 30% of the total.

TABLE 1

Ibero-America: External Financing

(Billions $)

	1998	1999	2000	2001	2002
1.0 Private flows, net	98.7	65.3	61.2	44.6	42.7
1.a Direct equity	50.1	74.8	57.1	49.0	35.0
1.b Private creditors	47.6	–1.3	8.9	2.0	8.6
2.0 Official flows, net	18.7	5.4	–10.2	26.1	22.6

Source: Institute of International Finance.

TABLE 2

Foreign Claims On Ibero-American Nations

(Billions $)

	2000 Q3	2000 Q4	2001 Q1	2001 Q2
Argentina	69.6	68.8	65.9	64.3
Brazil	63.8	67.6	67.8	69.5
Mexico	61.6	63.6	69.0	67.6

Source: Bank for International Settlements.