The fraud of Argentine convertibility

Those who are tempted to adopt the British "currency board" scheme should look at Argentina. Gerardo Terán Canal and Gonzalo Huertas report.

In the early months of 1998, as the Asian crisis worsened, Steve Hanke, a Johns Hopkins University economics professor and former adviser to Argentine Economics Minister Domingo Cavallo, joined with Sir Alan Walters, former adviser to then-British Prime Minister Margaret Thatcher, in urging Indonesia to adopt a "currency board," like that which Argentina has in place under the name "Convertibility Plan."

These currency board propagandists insisted that the adoption of such an economic model would give Indonesia the "maturity" demanded of the so-called emerging countries by speculators such as George Soros, and through which they would supposedly be able to integrate themselves into the globalization process. They never tire of arguing that convertibility allegedly enabled Argentina to easily resist the so-called "Tequila Effect" following the 1994-95 Mexican crisis.

Notwithstanding the myths spread by Hanke, Walters, Domingo Cavallo, and the rest, Argentina's Convertibility Plan has meant the destruction of its national productive apparatus, a loss of control over strategic state companies, a drastic increase in the rate of unemployment, and the de-nationalization of the national financial system. That is, what the Convertibility Plan guaranteed, is that the international banks, and especially the British Commonwealth, had seized control of approximately 53% of Argentina's financial assets, through mid-1997. Five years earlier, only 17% were in foreign hands.

In this second phase of the international financial crisis, known as the "Asian crisis," the next wave of buyouts of the Argentine banking sector is being readied. As the director general of Banco Bilbao Vizcaya, José Ignacio Goirigolzarri, declared during his early-1998 visit to Buenos Aires, the "Argentine financial system, as it exists today, is but a shadow of the system yet to come."

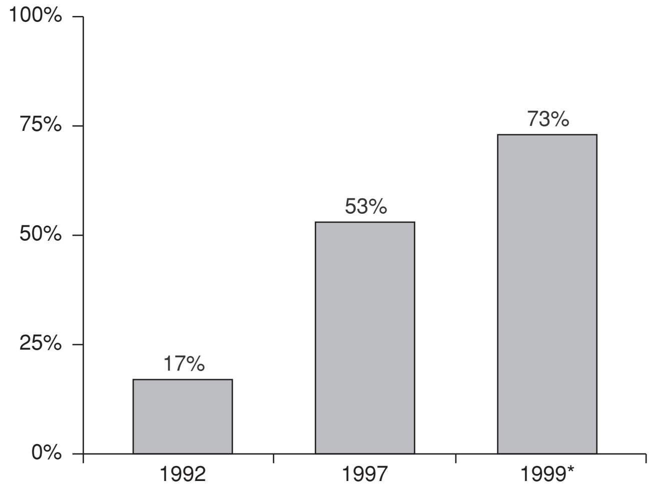
The Argentine Central Bank recently suspended the operations of Banco Patricios for 30 days, and just a few weeks ago did the same with the bank UNB Medefín. In both cases, the majority partner is Switzerland's Socimer Finance Group, which lost $100 million in the Asian financial crisis, and has been forced to reduce its investments in Argentina. It was thus unable to comply with the Argentine Central Bank's new guidelines.

Last December, Lloyds Bank bought up Banco Comercial de Tres Arroyos; in February 1998, Mercobank acquired the suspended Banco de Credito Provincial. Another local bank, the Banco de Galicia (with a branch in London), is also searching for a foreign buyer.

FIGURE 1

Argentina: foreign-controlled bank assets

(percentage of country's total bank assets)



*projection.

Source: Central Bank, Argentina; EIR.

At the same time, the international creditors and the International Monetary Fund (IMF) are demanding the privatization of the Banco de la Nación Argentina and the Banco de la Provincia de Buenos Aires, the country's two largest banks, whose financial assets account for 20% of the system. If these are privatized and end up in foreign hands, as is expected, then 73% of the Argentine banking system will be under foreign control (see **Figure 1**).

Banco de la Nación Argentina is the only bank with a presence in every township in the country, which has led it to function as the circulatory system of Argentina's regional economies. This privatization effort is encountering fierce resistance, however. For example, the Banking Association

TABLE 1
Argentina: real foreign debt
(billions $)

Year	1993	1994	1995	1996	1997*
1. Public foreign debt	55.5	60.0	63.0	73.6	73.1
2. Private foreign debt	15.1	17.4	20.0	26.1	32.4
Official foreign debt (1+2)	70.6	77.4	83.0	99.7	105.5
3. Government bonds denominated in foreign currencies	8.6	12.0	18.2	19.6	20.5
4. Peso-denominated government bonds held by foreigners	3.0	2.4	2.1	2.8	3.1
5. Dollar-denominated private domestic debt	19.0	19.0	19.0	31.5	34.1
De facto foreign debt (3+4+5)	30.6	33.4	39.3	53.9	57.7
Total (1+2+3+4+5)	101.2	110.8	122.3	153.6	163.2

* through September 1997
Source: Ministry of Economics

has launched a campaign to gather 1 million signatures from Argentine citizens opposed to the privatization.

Foreign debt growing

Since the implementation of the Convertibility Plan in 1991, the Argentine foreign debt has dramatically increased, rather than decreased, because of the "anti-inflationary" effects of the plan, as had been promised by its promoters.

According to the methodology that *EIR* has used in recent years, the *real* foreign debt of Argentina is significantly larger than the *official* foreign debt (see **Table 1**). The real foreign debt by the end of the third quarter of 1997 was $163.193 billion, compared with $101.2 billion in 1993: an increase of more than 60% in four years! The real foreign debt is $4,800 for each one of Argentina's 34 million citizens.

The difference between *EIR*'s figures and the official ones, is that the latter do not include a series of categories of *de facto foreign obligations:* the internal debt (both public and private) denominated in foreign currency, and the public internal debt, in pesos, held by foreigners (which is approximately one-third of the total). Therefore, to the $105.45 billion of official foreign debt, one must add:

1. public bonds issued in foreign currency and sold on the local market, worth $20.488 billion;

2. one-third of the $9.317 billion in public bonds issued on the local market and bought by foreigners, accounting for some $3.124 billion;

3. the dollar debt that Argentines hold in the local financial system, representing 63% of the banks' portfolios, which by Aug. 30, 1997 was $52.832 billion. To avoid double-counting, we must subtract from this figure the $18.721 billion which is the foreign debt of private and public banks, which in turn is lent to the private and public sector, and to the Argentine population in general (credit cards, mortgages, loans, and so on). If we make this adjustment, the internal private debt in dollars is $34.111 billion. This has grown some $19 billion since 1993—this evident dollarization of the Argentine financial system is a direct consequence of convertibility.

Adding these de facto foreign obligations to the official foreign debt of $105.450 billion, we get a real foreign debt as of Sept. 30, 1997 of $163.193 billion.

This year, Argentina will have to pay $19.615 billion in debt service (interest and amortization). In order to do this, the Argentine government issued in just the first 56 days of 1998, public bonds on the order of $3.25 billion. It is also negotiating a loan for another $1 billion with five international banks, including J.P. Morgan, Chase Manhattan Bank, and SBC Warburg.

Trade deficit growing

Just as in Indonesia, the IMF's prescriptions are destroying the trade and physical economy of Argentina.

On Feb. 4, the Menem government signed a letter of intent with the IMF, for an extended-facility loan of $2.8 billion, to be disbursed over the next three years. Two weeks later, the agreement collapsed.

Because of the international financial crisis unleashed in Southeast Asia, Argentine exports fell considerably between October and December 1997, closing the year at $25.359 billion. According to figures from the National Statistics and Census Institute (INDEC), the 1997 trade deficit was $4.948 billion. But, half of that deficit was generated in the last three months of the year. The monthly average of the trade deficit during the first nine months was $298 million, while the average for the final three months rose 253%.

This made it impossible for Argentina to comply with the newest IMF conditionality, that its trade deficit by the end of 1998 be less than $5 billion.

In 1997, the East and Southeast Asia nations of South Korea, the Philippines, Hong Kong, Indonesia, Singapore, Thailand, and Taiwan imported meat, cereal grains, and leather from Argentina, to the tune of $1.264 billion. This region, which regularly buys 50% of the leather Argentina exports, reduced its leather purchases by 15% between October and December 1997.

But the greatest impact can be seen on trade with Brazil, a nation severely affected by the Asian crisis. In 1997, Brazil bought 30% of Argentina's total exports, of which 41.5% were industrial products (mainly from the automotive sector), and the rest largely agricultural.

In 1997, Brazil imported $6.53 billion worth of products from Argentina, corresponding to 60% of Argentina's wheat exports, 50% of wheat flour exports, 11% of its beef exports, 35% of its cotton, 36% of its *mate* drink, 50% of its tomatoes, 80% of its onions, 60% of its garlic crop, 40% of its apples and pears, 77% of its barley, and more.

Given that the Argentine automotive industry heavily relies on its exports to Brazil, according to the Association of Automobile Manufacturers, Brazilian import-control measures produced a 14.3% fall in sales to Brazil in November, compared to the previous month. This forced automobile companies to put their workers on forced holiday, while auto parts manufacturers had to lay off many of their operators. The result of all this was that, between October and December 1997, stocks of the main automakers showed losses on the stock exchange of 50-60%.

To the reduction of exports to Asia and Brazil, we must add the fall in the international prices of cereal, fuel, and minerals, among others, all of which presages a very difficult year to come for Argentine trade. In minerals, the government had hoped to bring in some $1.3 billion. But, as economist Daniel Muchnik wrote on Feb. 6 in his weekly column in the newspaper *Clarín,* a 20% fall in oil prices "will strip Argentina of some $500 million from crude exports."

Production collapses

As can be expected, industries have also been affected in the internal markets by the international financial crisis. INDEC reveals that between November and December 1997, industrial activity in physical terms fell by 16.7% (10% in November and 6.7% in December).

Also seriously affected is the construction sector. Aldo Roggio, president of the Argentine Construction Council, stated that, following the Asian crisis, they have suffered "a deceleration of the growth curve in construction." In November 1997, cement production fell 10.7% with respect to the previous month. The story was the same with trade and other sectors of the Argentine economy.

This has clearly triggered a rise in unemployment. In the last two months of 1997, industrial employment fell 4.3%. Ironically, employment in the sector of "financial services, insurance, and real estate" saw a 32.8% rise in employment during that same period, according to the latest Census of Labor Indicators of the Labor Ministry.

Last October, real unemployment was 26.8% of the Economically Active Population, that is, 13.7% unemployment and 13.1% underemployment. Worse still, according to *Clarín* journalist Ismael Bermúdez, 60% of all new jobs that have been created are "a kind of disguised unemployment," and the other 40% "aren't really full-time wage earners." During the past two years, in the Federal Capital and in Greater Buenos Aires alone, 70,000 workers have had to work two jobs to afford the basic market basket.

In order to resolve their financial problems, the privatized public sectors raised their rates by an average 16% between Nov. 1, 1997 and the first half of February 1998.

Another goal agreed upon with the IMF, which the Menem government has been unable to meet, is the reduction of the fiscal deficit to less than $3.5 billion. Toward that end, the government sent a tax-reform bill to the National Congress which, as Muchnik described it, is "a tax reform designed by the IMF," and which virtually condemns the Argentine middle class to extinction.

The Federal Administration of Public Revenues has announced that, to prevent tax evasion, which in 1997 amounted to $28.8 billion, all tax evaders would be prosecuted, and a "political trial" demanded against those judges who did not rule against the evaders. The Congress is also now studying possible implementation of an Economics Ministry bill to privatize the collection of back taxes owed, by means of which the government hopes to collect another $6 billion.

Serious difficulties have also emerged regarding social security, because of the fact that only 51% of those affiliated with the pension funds (AFJP) paid in their contributions to the system in 1997, thereby causing delays in pension payments issued to retirees. The AFJP lost nearly $3 billion between October and December 1997, which had been invested in financial derivatives and stocks, which lost their value on the stock markets because of the Southeast Asia crisis.

In a desperate attempt to recover some of these funds, the government approved last August, amid great fanfare, a special retirement regimen for "housewives," with the intent of signing up 1 million housewives in the first year. However, between August and December 1997, only 50 housewives signed up.