Argentina on the edge of default—Is Brazil next?

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In recent meetings with Wall Street bankers and members of the Bush administration, Argentina's President Fernando De la Rua and Economics Minister Domingo Cavallo outlined the latest scheme to prevent an outright default on the country's $132 billion debt.

Under the plan, holders of Argentine bonds that currently yield 12 percent over their face value would swap them for zero-yield bonds for three years, with a seven-percent yield thereafter. Tax receipts would back the new bonds.

Initially, Wall Street bankers received the plan coolly, warning that there was not a sufficiently firm political consensus between Argentine federal and provincial authorities on cuts in federal transfers to the provinces. This week De la Rua announced that an agreement had been reached with the provinces.

Now it is likely that negotiations will take place with creditors, who will settle on a set of concessions, combined with an International Monetary Fund (IMF) rescue package and an agreement that the De la Rua government will observe strict fiscal discipline. Whatever plan is finally decided upon, there is no doubt that the Argentine rulers and international bankers intend to secure the debt payments by drastically slashing the living standards of the Argentine working class.

Argentina's 42-month-long economic recession has produced a sobering balance sheet. In the last year alone, the construction industry has registered a 25 percent decline; supermarket sales are down 8 percent; shopping centers, 22 percent; and public transportation, 11 percent. Industrial activity fell 8.8 percent in October alone, the fifth consecutive monthly decline. In September it had dropped 10.4 percent. The October figures reflect a 34 percent drop in auto and a 16 percent drop in steel. Tax receipts dropped nearly 9 percent.

Twenty percent of the labor force is unemployed, with many who are still working having reduced hours and wages. In the public sector, the temporary wage and pension cuts imposed as part of July's "zero deficit" plan have now become permanent. Forty percent of the nation's industrial capacity lies idle.

The impact on the automobile industry has been severe. Monthly auto sales have dropped from an average of 25,000 in 1998 to less than 15,000.

Fiat and Renault just announced that hundreds will be laid off at their Cordoba plants. The industrial city of Cordoba, is the center of Argentina's car manufacturing. Fiat is contemplating moving its production out of Cordoba altogether. Volkswagen announced wage cuts of 15 percent, together with the suspension of one-third of its workers. Those left will be working the 35-hour "Volkswagen week."

In May, average monthly wages were estimated at $576 for the 9.2 million work force. Half of the workers earn less than the median salary of $400 monthly. In October 2000 the average and median had been $587 and $448 respectively.

These figures show that while average wages dropped about 2 percent, earnings for the poorest workers dropped 10.7 percent. But these statistics conceal the real impact of the fall in income, since they do not count the growing number of workers entering an underground economy that pays starvation wages to domestic servants, at-home workers, street hawkers, and various forms of disguised begging. Roaming bands of homeless street children engaged in petty crime are now common in Argentine cities.

Compounding this impoverishment are regional differences that reveal profound distress for families in the interior. In provinces along the border with Brazil, the median wage stands at a miserable $300.

Officially the monthly income for a family of four at the poverty line is $470. This would describe the condition of 40 percent of the population. A more realistic estimate by Argentina's Foundation of Economic and Developmental Inquiry (FIDE) sets the minimum for a family of four at $1,000, an amount that would cover basic food, shelter, clothing and educational services.

FIDE and other observers note that there has been a serious diminution of consumption of even the most elementary services and consumer items. Tens of thousands go hungry every night.

The human cost to Argentine working people indicated by these figures is staggering: it is impossible to calculate the toll in the destruction of people's lives, the erosion of family relations and the collapse of neighborhoods. Looming above everything, like a sword of Damocles, is the power that domestic and international capitalist financiers and speculators have to move billions of dollars from one region to another,

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while national governments restrict their role to the control of social unrest.

The De la Rua administration clings to a fiction that there is no default on the horizon. Yet this nation of 37 million inhabitants is being denied further access to world credit markets in anticipation of an open default.

Much has been made of Argentina's $132 billion debt to international money market banks. One story goes that, beginning in 1995, a corrupt and profligate president, Carlos Menem, irresponsibly and single-handedly borrowed the funds to insure his re-election, banking on continued economic growth that would have made debt service relatively painless. Except for 1995, gross domestic product growth between 1994 and 1998 oscillated between 4 and 8 percent annually.

While Menem's presidential ambitions and the corruption of his administration certainly were negative factors in the Argentine crisis, its root causes lie in the 1997 Asian crisis, the 1998 Russian debt default and the 1999 Brazilian balance of payments crisis.

The mid-1997 collapse of the Asian Tiger economies and the Russian default made international investors increasingly cautious about putting money in what economists now call "emerging nations," like Argentina and Brazil, that are economically dependent on and politically dominated by nations like the United State, Germany and Japan.

This resulted in high interest rates worldwide. A typical example is Brazil, where money market rates increased from 22 percent in November 1997 to 42 percent in October 1998.

Those same conditions had forced Russia to default on its debts in 1998, despite IMF rescue efforts. That event put further pressure on the Brazilian economy. Again, despite an IMF rescue package, Brazil, hobbled by double-digit rates of unemployment and more than $300 billion in debt, allowed its currency to depreciate by 44 percent on January 29, 1999.

While the Brazilian crisis rippled throughout Latin America and the rest of the world, it had a devastating impact on Argentina and its partners in the Mercosur Common Market, Uruguay and Paraguay.

Currently, roughly 30 percent of Argentina's foreign trade is with Brazil. Since June, Argentine industrial exports to Brazil are down 50 percent.

As the economy went into recession, the Menem administration embarked on a massive privatization of public utilities and industries and the creation of structures to make the state economically passive, including a strong peg of the peso to the US dollar. These policies were continued by the De la Rua, who succeeded Menem in 1999.

Both regimes had hoped that self-regulating mechanisms, based on a rapid drop in Argentine wages and an inflow of foreign capital, would make the economy grow once more, according to neo-liberal prescriptions.

Domestic capitalists, meanwhile, are protecting their wealth by liquidating the country's assets and moving funds to regions considered more likely to produce profit, just like their foreign counterparts.

So far, every measure taken since the situation developed into a full-blown crisis has pushed the economy the wrong way and further impoverished the Argentine working and middle classes. Beggars in Buenos Aires now include former blue- and white-collar workers. Homelessness and hunger are on the rise. Society has become increasingly polarized.

Oblivious to this social devastation, economic voices such as the *Financial Times* and the *Economist* are openly calling for the devaluation of the Argentine peso and some type of negotiated default. "End the Agony," counsels the *Economist*. A recent editorial in the *Financial Times* declares that further rescue attempts will be futile, comparing them to refinancing the Titanic as it sinks.

The international economic impact is already being felt, as the Brazilian currency accelerates its downward spiral against the dollar. The Brazilian real fell 2.3 percent in June, 5.5 percent in July and 10 percent in the last week of September. Despite five interest rate increases so far this year to stop the outflow of capital, the real has fallen 23 percent, making it the 55th worst performing currency on a list of 56 kept by the German *Comerzbank*, behind the South African rand and just ahead of the crippled Turkish lira.

The drop in currency value has had devastating effects on Brazil's public dollar-denominated debt. Figures for the first seven months of the year indicate that interest payments on the public debt steadily rose from 3 to 17 billion reales. For the entire seven-month period, it was the annual equivalent of 11 percent of GDP, up from 6.5 percent in January.

The Brazilian Central Bank is having trouble raising funds at manageable interest rates, just as growing debts come to term and the public deficit continues to rise. In June, government expenses were 6.37 percent higher than tax receipts, compared with 3.53 percent in June 2000. Brazil must repay or refinance $74 billion next year, out of a total public debt of $305 billion. If one adds private debts, the total adds up to $640 billion, roughly 120 percent of GDP.

According to the *Financial Times*, Brazil's vulnerability is "very similar" to that of Argentina. Under these conditions, any prediction that the global economy is insulated from an Argentine-Brazilian collapse amounts to whistling in the dark.

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