Fearing default, Argentina moves to nationalize private pension funds

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24 October 2008

Argentina's President Cristina Fernandez de Kirchner proposed legislation Tuesday to nationalize the country's private pension funds—known in Spanish as AFJPs—in an attempt to stave off a new government default on its debt. It is expected that Congress, controlled by the Fernandez's Peronist party and its allies, will pass the measure in the next several days.

The $29 billion in the privately run retirement accounts will come in handy for the Argentine government as it struggles to "find new sources of funding for the government since the global financial crisis complicated efforts to renegotiate $20 billion in defaulted bonds and pay off abut $6.7 billion owed to the Paris Club group of creditors," reported Bloomberg News.

Making the announcement at a rally in Buenos Aires, President Fernandez justified the measure by comparing it to emergency bailouts of the financial sector that have been mounted in the US and Europe. "We are taking this decision in a context where the biggest countries, members of the G8 and others, are taking protective measures for their banks.... Instead, we're taking them for our retirees and workers," she said.

She claimed that the measure was being taken to protect pensioners from the violent fluctuations of the financial markets, not as a state cash grab.

Speaking alongside President Fernandez, the head of Argentina's social security administration, Amado Boudou, said the establishment of private pensions was an "enormous error" and constituted a "failed experiment."

Fernandez's words are pure demagogy. The reality is that Argentina is desperate for funds to avoid another default, which would be a disaster for the government. The measure has been hailed by the labor union bureaucracy, which fears another default could ignite massive social unrest.

The government seized the opportunity to take over the 10 funds after they had lost 2.25 percent in value over the last 12 months as a direct consequence of the world financial crisis. The real aim is to use workers' savings to bail out Argentine capitalists and international investors.

The move against the private pensions comes barely a week after the government floated other potential emergency measures, including a labor-management pact that would include a wage freeze. The right-wing Peronist CGT union federation leadership indicated that it was disposed to accept such a freeze in light of the crisis.

The government's right-wing opposition, including sections of Peronism itself, indicated that it would oppose the nationalization of the pension funds. The right is seeking to whip up fears within the population that are founded in large part on the catastrophe unleashed upon the large sections of the middle class and working class during the December 2001 default, when the government seized private bank accounts.

Meanwhile, in preparation for implementing the state takeover, squads of federal police raided the offices of the country's 10 main AFJPs, confiscating documents and files. The stated aim of the raids was to uncover evidence that the managements of the funds had engaged in illegal financial maneuvers, selling off stocks and bonds in anticipation of Fernandez's announcement.

Global markets reaction

Following the announcement, the international financial markets quickly moved to punish the already embattled Argentine economy with a massive selloff of stocks.

The benchmark Merval stock index, which closed at 1,216 last Friday, plunged to 865, a drop of 29 percent in three days, bringing the losses for 2008 to nearly 60 percent, topping Brazil and Peru as the worst-performing stock market in the world. Shares of the telephone company dropped to $3.80 from a close of $7.50 on October 14, a slide of 50 percent in one week.

Some foreign companies had invested heavily in the AFJPs. These include Banco Bilbao Vizcaya Argentaria (BBVA), HSBC, ING and MetLife. The day after the measure was announced, BBVA slid 6.5 percent in Madrid and Repsol YPF SA, Spain's biggest oil producer, fell 13 percent.

Argentina's move to avoid its second country-default this decade (it defaulted in 2001) did not stop foreign investors from making bitter criticisms, according to Bloomberg News.

"It is the final of many nails in the coffin from an institutional investor perspective," said Bill Rudman from WestLB Mellon, which has a $3 billion emerging-market equity fund. "We are going back to the dark ages," said Jaime Valdivia, who manages $1 billion of assets for Emerging Sovereign Group in New York.

"When you change rules, foreign investors flee," said Greg Lesko, who helps oversee $900 million at Deltec Asset Management Corp. in New York, arrogantly adding, "I have a hard time believing people will look at that and say this is a serious country."

From that perspective, looking at the debacle on Wall Street and the pouring of vast public resources into the private accounts of banks and finance houses, the US ranks among the least "serious" countries in the world. What Mr. Valdivia, Rudman and Lesko are really expressing is their rage against a measure that will curtail their ability to keep looting Argentina and especially its pension funds.

Created in 1994, at the height of privatizations by the Peronist government of President Carlos Menem, the funds have produced a 13.9 percent average annual return. By law, they have been required to spend a significant percentage of the retirees' money to prop up the local stock and bond markets.

Due in large measure to AFJP money, trading volume on the Buenos Aires stock exchange had quadrupled since 1994, counting on a steady flow of hundreds of million of dollars of retirees' contributions. Foreign

banks and investment firms moved quickly to offer all sorts of complex derivatives products to take advantage of Argentina's inexperience and book usurious profit levels.

At the end of September, 55 percent of the funds' $29 billion had been invested in government debt and $4.1 billion or 13 percent in domestic stocks. In September alone, AFJPs put $144 million into the Argentine stock market, precisely at the time the world equity markets were entering their worst performance period in history.

Closer to the abyss

Others in the global markets, motivated more by fear, justify President Fernandez's measure because they see the danger of Argentina defaulting and the ripple effect it could have throughout the so-called emerging markets, where governments are struggling to overcome the global financial crisis.

In a telephone interview with Bloomberg News, Siobhan Morden, a Latin America debt strategist for RBC in New York, said that the move could provide the government with financing needed to avert default as debt obligations grow next year.

Forbes.com writes: "Economists said more than $4 billion a year in contributions to pension funds would ease government financing needs in 2009, when the government faces mid-term elections. Public spending has historically risen in election years."

Argentina has been shut out of the international capital markets since it defaulted in 2001. In that year, bonds lost 62 percent of value, while so far this year, they have lost 37 percent. But this figure, along with the jump of 3.67 percent points to 35.8 percent on credit default swaps, is an indication that Argentina is getting very close to the abyss.

To understand how close Argentina is to defaulting, imagine a concerned father wanting to buy a $1 million term life insurance policy for five years to protect his family. If the father's likelihood of dying were similar to that of Argentina defaulting, the insurance would cost him $358,000!

Similar to many other emerging market countries, the Argentine economy grew at a pace of 8.8 percent over the past five years. This year, its growth rate is expected to slump to 5 percent—partially sustained by high commodity prices over the first five months of the year—and the government (optimistically) projects 2.5 percent for 2009.

Things started to look grim for Argentina as commodity prices dropped 40 percent from a record high reached in early July. More than half of Argentina's earnings come from wheat, soybeans, corn and other export commodities.

Simultaneously, "foreign emerging-markets funds sold $250 million in Argentine stock through August of this year in the biggest outflow since 2000," according to Bloomberg News.

Historical significance of the collapse of AFJPs

Private pension funds have become an important aspect of the policy to insert so-called emerging nations into the global markets. They played a central role in funding local stock exchanges, debt and mortgage markets.

Contrary to expectations that financial innovation would come from an advanced, highly industrialized country, with a strong, mature financial industry, the origins of private pension funds are to be found not in the US or Europe, but in Latin America.

It is not the product of Wall Street or the City of London, but of the fascist-military junta of Chilean General Augusto Pinochet. The Chilean private pension funds were created in the 1980s at a time when tanks occupied the streets to silence any opposition, especially demonstrations of discontent by the Chilean working class.

It is under these conditions that a group of economists—followers of Milton Friedman, known as the Chicago Boys—came up with the idea of creating and testing pension funds, taking advantage of military rule. The 1980s were years of enormous hardship for the Chilean workers.

Initially, workers were given the option of choosing between the old state-run pension system and the new privately run pensions. Beginning in January 1983, however, all new-hires were compelled to enroll in the private system. The contribution was a fixed 10 percent of salary.

Today we can see the Chilean "economic miracle" as part of a world shift to the right, which in the advanced countries was symbolized by the free-market and union-busting measures pursued by Reagan and Thatcher. In reality, the "economic miracle" was based on a huge transfer of wealth from the Chilean working class to the Chilean and international bourgeoisie. The implementation—and success—of the private pension funds was part of this transfer of wealth.

The Chilean private funds helped finance privatizations and went from owning 1.1 percent of domestic stocks and bonds in 1985 to 32 percent in 1996. By 1997, they had become the largest investor in the Chilean capital markets.

Inspired by Chile, dozens of countries have implemented private pension funds, from neighboring Peru and Argentina, to Latvia and Kazakhstan. In its attempt to attack the social security system in the US, President Bush praised Chile and used it as an example of what he wanted to accomplish.

But history has made a 180-degree turn. Every day the world financial crisis brings new surprises, exposing the fragility and hollowness of the supposed miracles of the free market used to justify the measures implemented by Reagan, Thatcher and Pinochet.

The measures being taken by the Kirchner government in Argentina—forced upon it by the worldwide capitalist crisis—will not ameliorate the conditions that this crisis has created for masses of workers and retirees, but only set the stage for a renewal of social struggles.