U.S. backs Argentine deflationary policy

by Peter Rush

A little over one week after the administration of Argentine President Carlos Menem imposed a program of radical deflation on the national economy, the local stock market has crashed, the banking system is reeling, the cabinet is wracked by infighting, and President Bush is hailing Menem's decision to "permit market forces to operate freely."

Finance Minister Antonio Ermán González announced the new program, dubbed the "Lazarus Plan," on Jan. 1 to deal with hyperinflation, which was officially 4,923% in 1989, and 40% in December. The plan sharply restricts the amount of national currency, the austral, in circulation. The plan resulted in temporarily halting, and even reversing, the slide in the value of the austral against the dollar, as businesses were forced to scramble to sell dollars to obtain australs to meet payrolls, and to pay suppliers and taxes. Up to two-thirds of all australs in circulation Jan. 3 may have been removed from circulation by Jan. 10, according to some estimates.

In the longer term, however, because of its monetarist character, this program cannot resolve the fundamental ills of the Argentine economy. The newly found "stability" of which the government is boasting, isn't expected to last more than a month or two. Chaos ensued in the first few days of the program. Thousands of people and companies have been caught midstream as the government changed horses, in many cases losing large amounts of money. Hardest hit were those who had been using the stock market as a hedge against hyperinflation. The market was intentionally kept closed for the first week in January in hopes of avoiding a panic selling, but, when its doors finally opened Jan. 8, it plunged 53.4% in one day. Thousands of investors had purchased shares on credit, expecting the market to continue its heady rise—average share values almost doubled in December alone—which they had to suddenly sell Jan. 8.

But thousands of other investors also lost, who had put their australs into high-interest seven-day bank deposit accounts and seven-day government bonds; they were unable to redeem their investments, except in long-term, dollar-denominated bonds, called Bonex. These bonds are already trading for only half their nominal value—meaning a 50% loss for investors, and a loss of access to liquid funds. Many banks, especially smaller ones, required to redeem the first 1 million australs of each depositor's deposits in australs, were unable to do so, and many are now threatened with bankruptcy.

Equally hit were consumers. In the final week of December, many prices were raised by 50% to 200%, in expectation of new devaluations. The government said that its new deflationary program would bring these prices back down, but so far most prices have remained far above their levels before Christmas.

Cabinet split

Despite the already sharp recessionary features of the new plan, the government announced that it will soon impose a drastic austerity package to cut the fiscal deficit from its current level of 12% of Gross National Product. While the details are yet to be announced, this certainly must entail firing thousands of government employees, which will further depress the economy. Also slated to be pared are bonuses for workers—essential supplements to inadequate wages and salaries—and central government payments to the provinces.

As the effects, some expected, some unexpected, of the new package take hold, the cabinet continues acrimonious debate as to what to do next. Foreign Minister Domingo Cavallo, who doesn't hide his desire to become finance minister, and who is the putative architect of the present plan, has been arguing that companies should be allowed to pay their debts to banks with the same Bonex they have received in place of their australs. This would have the effect of forcing the banking system, rather than the industrial sector, to take the largest hit from the new program. But Cavallo, who reportedly told top officials that he alone had "saved" the government from disaster in the closing days of 1989, hasn't endeared himself with other cabinet members, particularly not with Menem associate Finance Minister Antonio Ermán González

After keeping a relatively low profile for a week, an unusual development, President Menem emerged Jan. 10 to state that he was "euphoric" about the "success" of the new plan. He also wrote a letter to President Bush urging the U.S. to approve an increase in International Monetary Fund quotas, so that countries like Argentina can receive more aid. Bush wrote back, "I firmly support your objective of restructuring the Argentine economy in a manner which permits the forces of the market to operate more freely." Bush specifically backed Menem's effort to cut the budget, and concluded saying, "I want to assure you that we are ready to continue working closely with you to achieve success for your economic program."

Menem insists that he, and he alone, is the author of the misnamed Lazarus Plan. However, it was only after a Dec. 29 meeting between Ermán González and U.S. Ambassador Terence Todman, that Ermán and Menem decided to junk a previous program and go with the present deflationary scheme. With the U.S. economy on the verge of its own blowout, Washington's backing for Menem's new program will not turn out the way Menem is hoping.