1988); Carlos Andrés Pérez in Venezuela (February 1989); Carlos Menem in Argentina (July 1989); and Fernando Collor de Mello in Brazil (December 1990).

The big trade surpluses of the 1980s have been replaced by the large, and growing, trade deficits of the 1990s, as free trade reforms have led to uncontrolled growth of imports. In order to pay for this deficit, and to cover the required debt service payments, the Ibero-American nations have been inundated with a flood of highly volatile speculative capital. If that flood reverses, or even just subsides—as has begun to occur in the first quarter of 1994—the nations of Ibero-America will be forced to default on their debt payments, and the debt bomb will detonate.

More broadly, sovereign national debt is rapidly and deliberately being supplanted in importance in the 1990s by various private and speculative financial flows. Since 1989, the bulk of foreign debt growth has been private, not public; entire chunks of the internal debt structure have become "internationalized," or de facto foreign debt; and foreign portfolio investment and other purely speculative activity are growing astronomically.

In fact, the very institution of the nation-state itself has become a primary obstacle to the current one-worldist plans of the financial establishment, and they have thus targeted it for extinction, along with the principal institutions responsible with defending it, such as the national armed forces (see *EIR*'s forthcoming book, *The Plot to Annihilate the Nations and the Armed Forces of Ibero-America.*) As Citibank President John Reed put it in an infamous 1990 interview with the Brazilian magazine *Veja:* "Countries have disappeared from the face of the earth. Peru and Bolivia will disappear."

The extension of NAFTA-type agreements to the entire continent is designed to deal with the final remaining problem that the banking crowd foresees: the danger that nations may try to buck the new world order by removing governments that will not defend their national interests. It has not escaped the bankers' notice that, of the four mentioned Ibero-American Presidents who implemented the Bush-Thatcher reforms starting in 1989, two of them—Venezuela's Carlos Andrés Pérez and Brazil's Fernando Collor—were subsequently thrown out of office as a result of their personal corruption and their adherence to these policies, and one of them (Pérez) is currently sitting in jail. With a continent-wide NAFTA, nations will be permitted to change governments if they like, but they will be prohibited from changing economic policy—by international treaty obligation.

Below, we present a detailed graphical report on the evolution and structure of this 1994 debt bomb, as well as case study documentation of the bankers' strategy—in their own words—focussed particularly on Venezuela, which is currently on the chopping block of these economic policies.

How the debt cancer went out of control

by Dennis Small and Peter Rush

There is a curious logic to the cancerous mass otherwise known as the Ibero-American debt: It seems that the more you pay, the more you end up owing. This is apparent from even a cursory glance at the official debt statistics made available by the World Bank. **Figure 1** tells the story for Ibero-America as a whole between 1980 and 1993. In 1980, the total official foreign debt was about $257 billion. Over the course of the next 13 years, a cumulative total of $372 billion was paid back to the banks in interest alone—i.e., this does not include any amortization payments. Yet despite the fact that the entire original debt of 1980 was paid back one and a half times over, the total foreign debt *grew* to $513 billion by 1993. This is almost exactly *double* the original debt of 1980. In other words, 257−372=513! That is what is known as "bankers' arithmetic."

After the Brady Plan debt reorganizations of 1989 and onward, the foreign debt continued to grow, as did the process of looting. Nearly $100 billion in additional interest payments were made between 1989 and 1993, and yet the

FIGURE 1
Ibero-America: foreign debt and cumulative interest paid
(billions $)

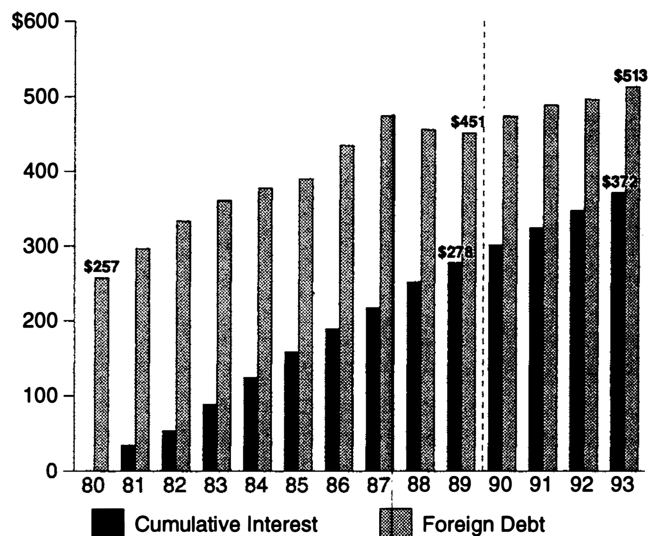

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FIGURE 2
Argentina: foreign debt and cumulative interest paid
(billions $)

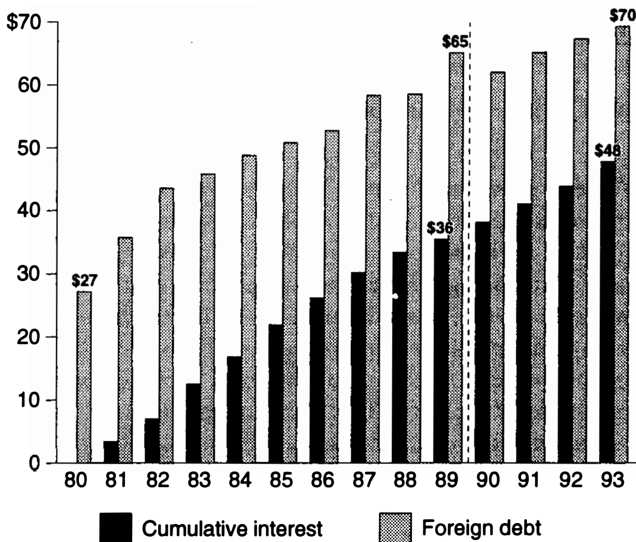


FIGURE 3
Brazil: foreign debt and cumulative interest paid
(billions $)

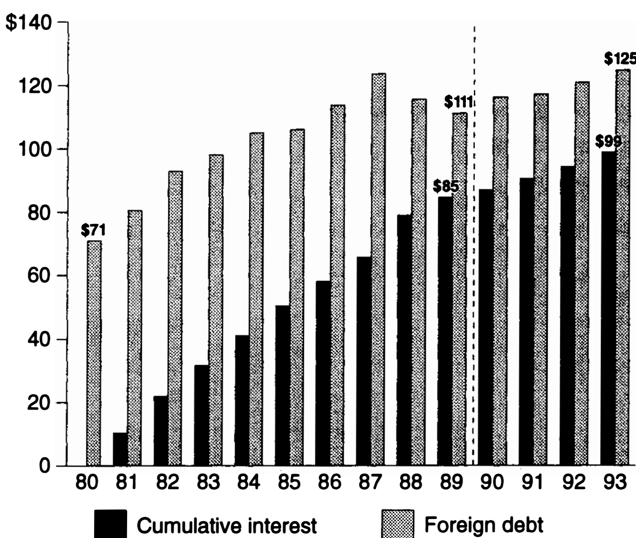


FIGURE 4
Mexico: foreign debt and cumulative interest paid
(billions $)

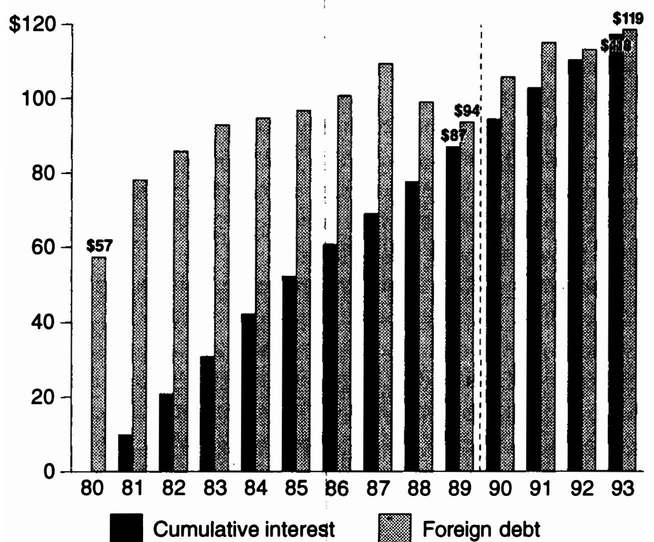
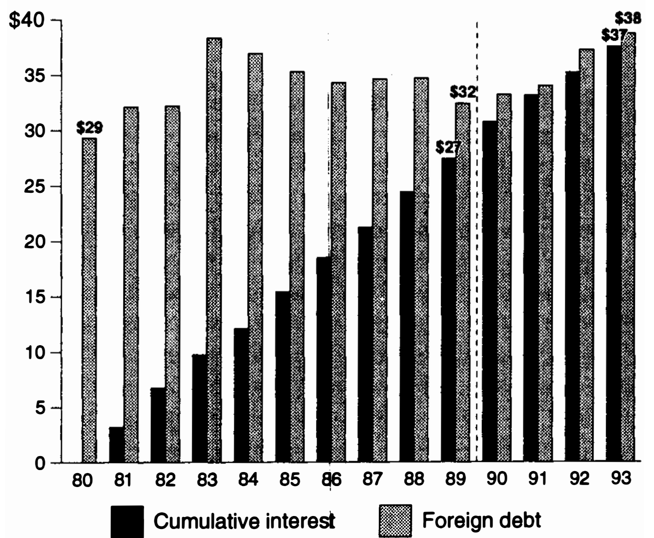
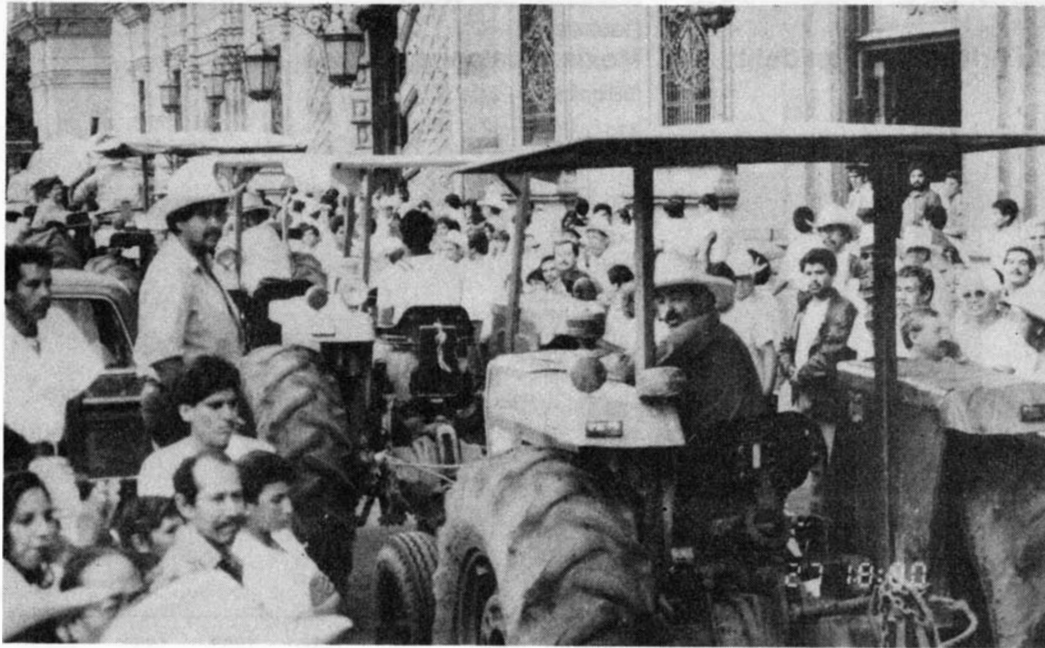


FIGURE 5
Venezuela: foreign debt and cumulative interest paid
(billions $)



total debt grew in this period by $62 billion. In **Figures 2** through **5,** we present the corresponding pictures for Argentina, Brazil, Mexico, and Venezuela—the four largest debtor nations in Ibero-America. Argentina's foreign debt grew the fastest of the four over this period, rising by 260% from $27 billion to $70 billion, despite the fact that they paid $48 in cumulative interest payments. The case of Mexico is even more shocking. Starting from a 1980 debt of $57 billion, Mexico has paid more than twice that amount in interest payments alone: $118 billion. And yet the total debt has



A tractorcade of farmers in Guadalajara, Mexico on Aug. 25, 1993, protesting the foreclosure of farms and the usurious cost of credit. Mexican farmers are being charged up to 34% for bank loans, driving them out of business and shutting down the nation's productive capacity.

also doubled, to a staggering $119 billion. Again we have "bankers' arithmetic": 57−118=119. Here, too, note that the debt continued to grow *after* the Brady consolidation, in fact at a more rapid rate than had occurred in the mid-1980s.

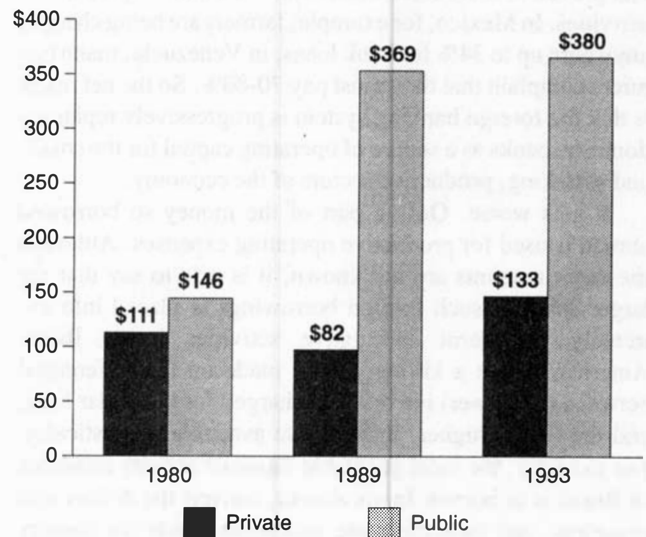
But now we must look at the changing composition of that growing foreign debt, in terms of the portion which is public (i.e., either owed directly by governments or guaranteed by them), and the portion which is owed by the private sector. We discover that the way in which the total foreign debt grew before 1989 is completely different from the way it happened after that turning point (see **Figure 6**). Before 1989, the entire growth was due to public sector debt, with private foreign debt actually shrinking in absolute terms, in part due to government takeover of substantial amounts of private debt in the mid 1980s in Venezuela and elsewhere. After 1989, the trend reversed: There was near-stagnation of public sector debt, while private sector indebtedness shot up from $82 billion to $133 billion, which accounted for over 80% of the total debt increase during this period. This is the first indication that Ibero-America's foreign debt has become progressively privatized since 1989.

This pattern holds for each of the major debtors in Ibero-America; but again, the case of Mexico makes the point most vividly. As **Figure 7** indicates, public debt grew from 1980-89, and then stagnated from 1989-93; while the private sector debt declined at first, and then grew particularly rapidly between 1989 and 1993, rising from $13 billion to $36 billion. The rate of growth of this private sector debt over 1989-93 averaged 29% per year, which is four times higher than the corresponding annual average growth rate of public debt from 1980-89 of 7.1%.

FIGURE 6

Ibero-America: public versus private foreign debt

(billions $)



Why are Mexican and other private companies borrowing so much money abroad? Is it because they are investing it in increased plant and equipment, buying capital goods abroad, or otherwise taking steps to raise output? If so, it could reasonably be argued that it will be offset by increased productive activity in the respective national economies. But that is not the case. A large part of this international borrowing is simply a replacement for loans that should be coming from

FIGURE 7
Mexico: public versus private foreign debt
(billions $)

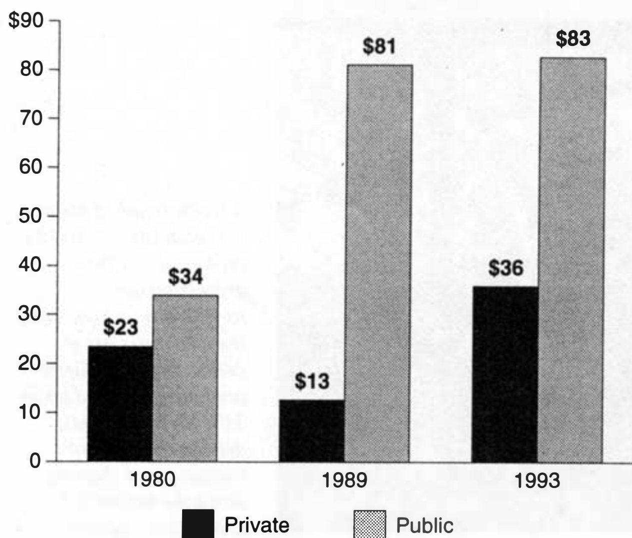
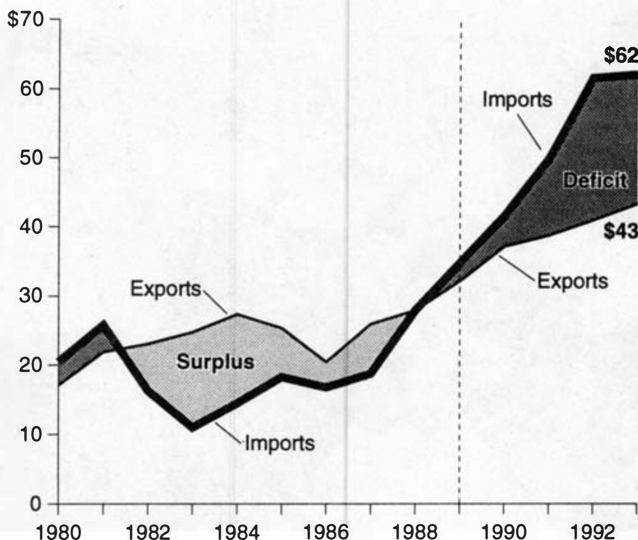


FIGURE 8
Mexico: balance of trade
(billions $)



the domestic banking system, but which are unavailable or are prohibitively expensive, due to the onerous interest rates that prevail in most Ibero-American countries for productive activities. In Mexico, for example, farmers are being charged anywhere up to 34% for bank loans; in Venezuela, manufacturers complain that they must pay 70-80%. So the net result is that the foreign banking system is progressively replacing domestic banks as a source of operating capital for the small, and shrinking, productive sectors of the economy.

It gets worse. Only a part of the money so borrowed abroad is used for productive operating expenses. Although the exact amounts are not known, it is safe to say that the larger share of such foreign borrowings is placed into extremely short-term speculative activities inside Ibero-America, where a killing can be made on the differential between the (lower) interest rate charged for the dollar loan, and the (much higher) interest rate available domestically. For example, the most profitable financial activity available in Brazil is to borrow funds abroad, convert the dollars into cruzeiros, and then speculate with them insidet he country on what is called the "overnight" market, where extremely short-term paper earns up to 54% interest *per month!* The money can then either be reinvested, or converted back into dollars and taken out of the country—a nice speculative killing, even when offset by Brazil's current monthly inflation rate of 43%.

This is truly hit-and-run finance, a banker's one-night stand, where capital flows into and out of the country virtually before it can be counted. It leaves behind no real wealth or productive activity, but only the gaping hole of the usurious profit margin it has looted from the country.

Who is paying for the trade deficit?

One of the most visible effects of the radical free trade policies imposed on Ibero-America in the late 1980s, has been the sharp rise in imports flooding into the area. Although the North American Free Trade Agreement (NAFTA) is the model for such policies, the fact is that similar developments were well under way four or five years before NAFTA was signed in 1993, through the General Agreement on Tariffs and Trade (GATT) and other arrangements. As **Figure 8** shows, Mexico's imports began to soar in 1988, when they joined GATT, and have since soared to over $62 billion in 1993. Under NAFTA, this trend is expected to continue and even accelerate.

Mexico is now importing everything under the sun, including numerous goods that it used to produce domestically. As a result, there is a wave of bankruptcies of domestic producers who cannot survive such "free trade" practices. This is especially damaging in the agricultural sector, where anywhere from one-third to one-half of all farmers are expected to disappear over the next year or two. And in manufacturing, entire sectors have been decimated by layoffs and plant closings, which has pushed real unemployment up to the 50% level.

As imports have skyrocketed, exports have stagnated, for the simple reason that the world economy is in the throes of a depression. This has led to a large and growing trade deficit which hit $19 billion in 1993.

The same process is under way in Argentina (see **Figure**

FIGURE 9
Argentina: balance of trade
(billions $)

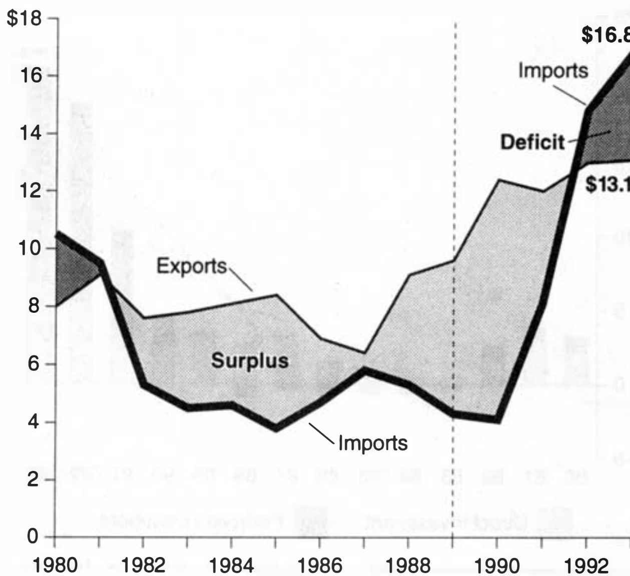
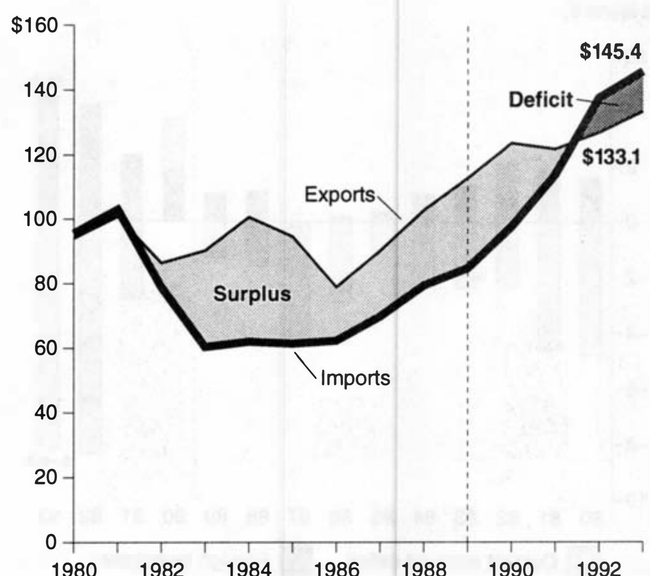


FIGURE 10
Ibero-America: balance of trade
(billions $)



9), which has historically produced a large trade surplus from its agricultural sector, but which has now also developed a large and growing trade deficit, thanks to a fourfold jump in imports over just three years—from $4.1 billion to $16.8 billion. Worse still, some Argentine analysts expect the 1993 trade deficit of $3.7 billion to soar to $6 billion in 1994, as the free-trade binge pushes imports up to the $21 billion level.

Although Brazil and Venezuela are not yet running trade deficits, the Argentine and Mexican cases have been enough to swing the total for Ibero-America into the red, beginning in 1992 (see **Figure 10**).

The shift in looting mechanisms referred to in the opening article of this package, is nowhere more clearly evident than in the following graphs showing the explosion of so called "foreign investment" to cover the mushrooming current account deficits in most countries of Ibero-America. As indicated above, the imposition of "free trade" policies on Mexico, Venezuela, Argentina, and other countries has led to a flood of imports uncompensated by comparable growth in exports. With the former trade supluses turning to deficits, there is nothing left to pay debt service, so each country in this situation has in four years found itself with enormous deficits on current account, which are, roughly speaking, the sum of trade deficits and interest payments.

The only way a current account deficit can be sustained is by an equivalent flow of capital into the country. **Figures 11, 12,** and **13** show the changed nature of that capital inflow. In the late 1970s, up until 1982, Ibero-American nations also ran large current account deficits, which were a mixture of trade deficits and flight capital leaving the country. A major portion of these deficits were "invisible" because they involved secretive flight capital that was only detectable by the huge run-up in government borrowings abroad which were

FIGURE 11
Mexico: foreign investment versus current account deficit
(billions $)

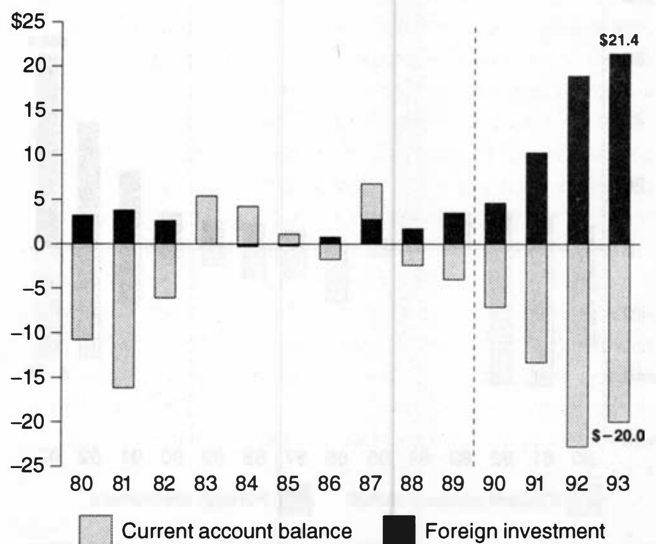


FIGURE 12
Argentina: foreign investment versus current account deficit
(billions $)

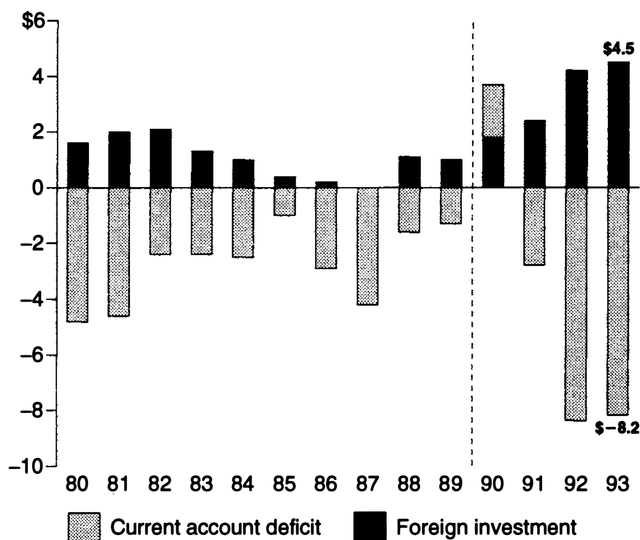


FIGURE 14
Mexico: foreign investment
(billions $)

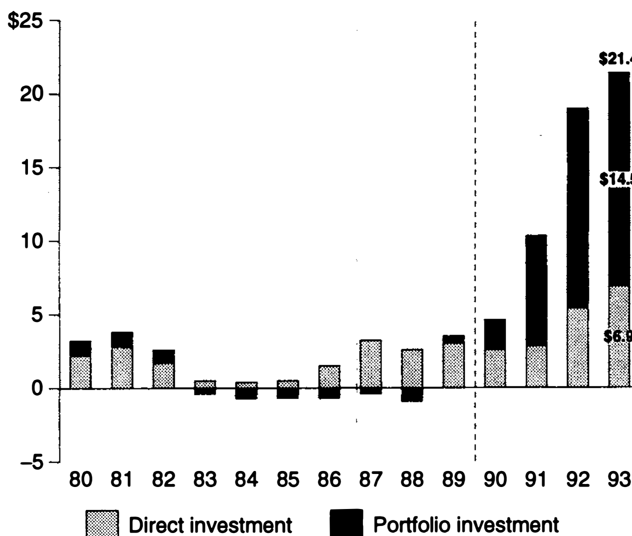
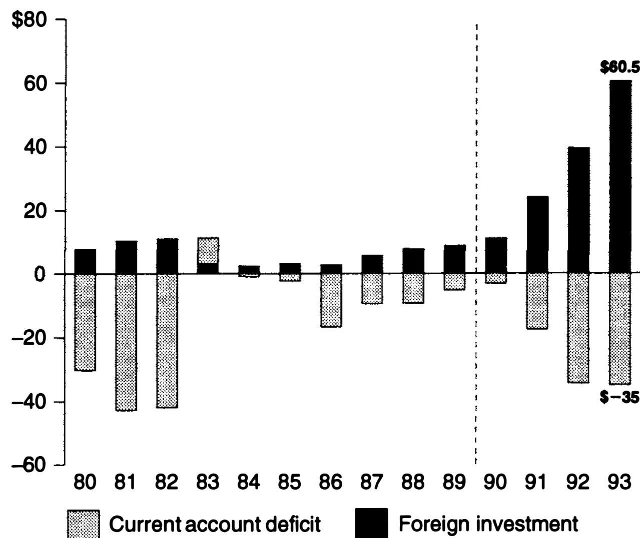


FIGURE 13
Ibero-America: foreign investment versus current account deficit
(billions $)



used to convert the capital-flight artists' domestic currency holdings into dollars so the money could flee the country. Combined with the borrowings to cover the official current account deficits, the debt of Ibero-America overall zoomed from under $100 billion in 1975 to nearly $350 billion in 1982.

As can be seen in the case of Mexico (Figure 11), starting in a small way in 1988 and taking off from 1991 forward, inflows of so-called "foreign investment" account for the vast bulk of the capital that permitted the country to run up such unprecedented current account deficits. The same pattern can be seen in Argentina (Figure 12), where foreign investment paid for fully half of the current account deficits, the rest apparently being covered by official government borrowings and other sources.

Figure 13 shows the figures for all of Ibero-America. Noted that figures from Brazil—which is still running a large trade surplus, while also receiving large capital inflows—change the pattern and cause foreign investment to appear larger than the aggregate continental current account surplus, which does not hold when observed on a country-by-country basis.

Portfolio speculation

Since the term "foreign investment" is a variegated category, determining the impact of these flows on the recipient countries depends on analyzing the composition of this category. **Figures 14-16** break it down into the two components customarily itemized in official statistics: "direct foreign investment" and "portfolio investment." Direct investment refers nominally to investment in the physical economy, such as buying or building factories, stores, hotels, etc. Portfolio investment is basically stock market investments by country mutual funds and private individuals, plus depository receipts, which is to say, the purchase and sale of equity instruments that lead to the creation of no new physical wealth of any kind, and these are generally invested in for their

FIGURE 15
Brazil: foreign investment
(billions $)

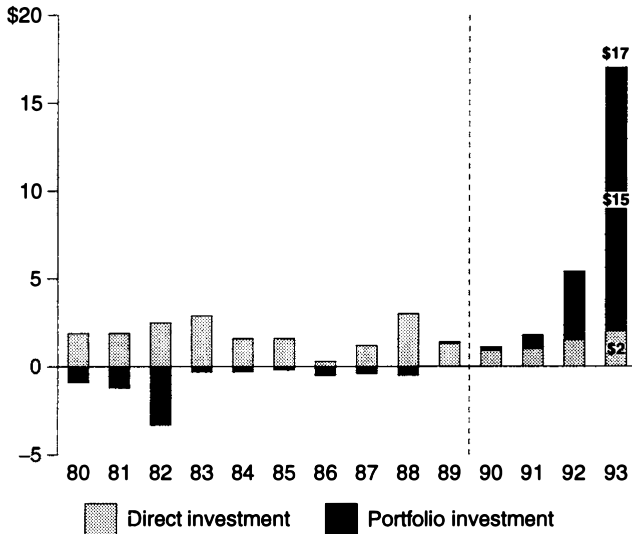
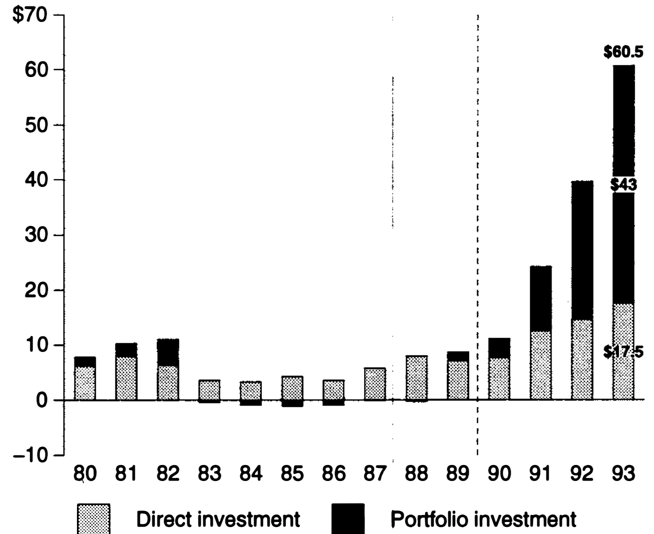


FIGURE 16
Ibero-America: foreign investment
(billions $)



speculative potential.

Looking at Figure 14 on Mexico, we see that total foreign investment, from being a negative net sum from 1983-85, grew to just over $3 billion in 1989, and since has ballooned to $21.4 billion in 1993. Its composition has also altered radically.

More than two-thirds of all of the foreign investment flowing into Mexico has been portfolio investment in the last three years. This reverses the pre-1989 pattern, where during 1983-88, portfolio investment was negative, turning slightly positive at under half a billion in 1989, before taking off in 1991-93, reaching $14.5 billion last year. This money is extremely volatile, especially since most of it has entered the country not to make long-term investments, but to take part in Mexico's stock market bubble of 1991-93, where the major gains were not in dividends, but in the exorbitant run-up in stock prices (see article, p. 24). If the stock market has a sustained decline, or a sudden crash, and investors don't believe it will come back any time soon, it will not be long before all the foreign money tries to leave at once, creating an unmanageable foreign exchange and balance of payments crisis.

Brazil (Figure 15) has sustained a similar vast inflow of portfolio investment, more than tripling in 1993 over 1992, a very dangerous development. Although the inflow in Brazil's case is not (yet) required to cover a current account deficit, if that money were to suddenly reverse and flow out, it would have devastating consequences for Brazil's foreign exchange position. And note that the quantity of direct foreign investment in Brazil is relatively negligible.

The picture for the continent as a whole is given in Figure 16. Nearly two-thirds of total foreign investment is accounted for by Mexico and Brazil, and within that, more than two-thirds of the total is portfolio. As for the portion of foreign investment reported as "direct foreign investment," if it represented direct investment in construction of new factories, it would at least be serving a positive growth function for the physical economy, by engendering production for domestic consumption and export. But sadly, this is largely not the case. Figures from Mexico for 1991 and 1992 show that the vast bulk of "direct foreign investment" has gone into tourism and services, and most of the rest into transportation and communications infrastructure geared to export, and not to developing the nation's domestic economy. Also, much of this money—in Mexico and overall in Ibero-America—is just a transfer of ownership of already existing productive companies from the state sector to private hands, as shown in **Figure 17.** Out of the only 29% of total investment that was direct, we estimate that more than one-third went to finance privatizations, which do not represent any new wealth being created inside the country. In the case of Argentina and Venezuela, for example, about 40% of total foreign direct investment went to pay for privatizations between 1991 and 1993.

The broader picture is given in **Figure 18,** which shows the net sum of all resource flows into Ibero-America since 1980.

As can be seen, public and private long-term debt accounted for nearly the entire resource flow from 1980-82, when the first debt bomb was detonated by the banks. Private long-term debt immediately vanished, and public long-term debt gradually shrank to zero as well, and in the last few years has alter-

FIGURE 17
Ibero-America: productive versus speculative foreign investment
(percent of total investment)

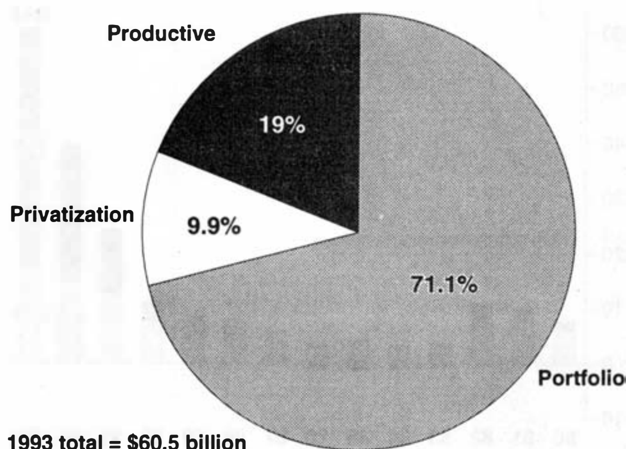
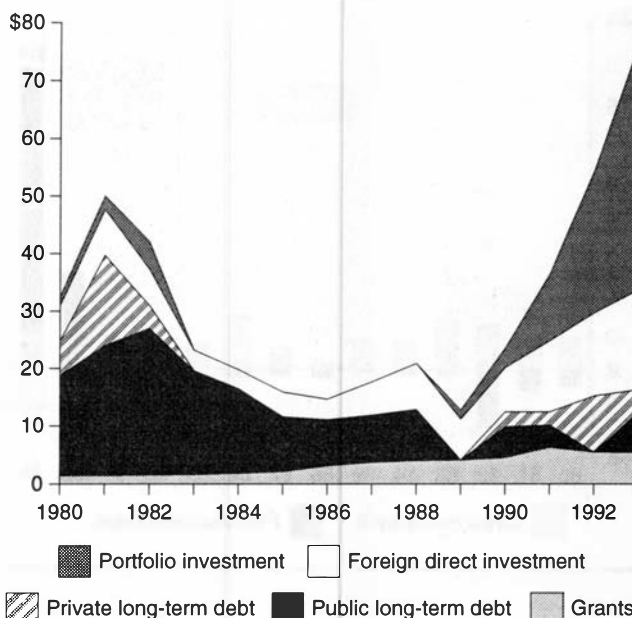


FIGURE 18
Ibero-America: net resource flows
(billions $)



nated between being zero and about $5 billion per year.

In contrast, foreign investment, which in 1980-82 was less than one-quarter of resource flows, now accounts for more than 80% of the total, which is itself 60% larger than the total flow of resources before the 1982 debt bomb.

The absolute magnitude of total flows alone should be setting off alarm bells in top financial circles, since all inflows of capital correspond to outflows that each country must make in interest, profits, or dividends. The enormous run-up of net resource inflows since the low point of 1989—nearly a 900% increase in just four years—represents an astounding rate of growth of total liabilities against which interest or its equivalent must be paid. Yet, manifestly, almost none of this vast inflow has been invested in enhancing the productive capacity of the host countries which would represent the only way that servicing the new obligations would be "paid for" by the proceeds of the investment.

The real foreign debt

In reality, the picture is far worse than even this. With the brute force ending of high inflation, the institution of currency convertibility, and the dismantling of barriers to international banks' and investors' free market activities in most countries, a new category of debt has arisen, which is nominally domestic or internal debt, but which is in fact an *international obligation,* either becasue it is held by foreigners, or is directly denominated in U.S. dollars. In either case, such "internal debt" functions as if it were foreign debt, in that it can also flee the country at a moment's notice.

The Mexican treasury bill, called the Cete, is an example of this. It is denominated in pesos, but two-thirds of the issue is owned by foreigners; and since there is free convertibility from the peso into the dollar, any day that these foreign holders decide not to roll over their investment as it comes due, the government would be saddled by an unpayable dollar obligation.

This "internationalized internal debt" has become particularly important in Mexico, Brazil, and Argentina, as shown in **Figure 19.** The greatest quantity of this is found in Argentina, because Argentina has pegged its currency directly to the dollar on a one-to-one relationship, and has permitted dollars to become virtually legal tender inside the country. Argentina thus has dollar-denominated internal debt, about $14 billion of it public, and $19 billion of it private. Total real foreign debt is $106 billion, a full 50% higher than official foreign debt of $70 billion.

In the case of Mexico, we have to add to the 1993 official foreign debt of $119 billion, another $26 billion in foreign held Cetes and other public peso debt, plus $38 billion in cumulative portfolio investment flows, which are also a de facto foreign obligation. Thus, Mexico's real foreign debt totals about $183 billion, which is also 50% larger than the official foreign debt.

In the case of Brazil, we must also add on to the official foreign debt the category of cumulative portfolio obligations, which totals $20 billion. And we have also added on another $21 billion in "internationalized" internal debt, which corresponds to about one-third of the total public internal debt of Brazil. Although Brazil, as of this writing, does not share the total dollar convertibility and one-for-one parity with the

FIGURE 19
Real foreign debt, 1993
(billions $)

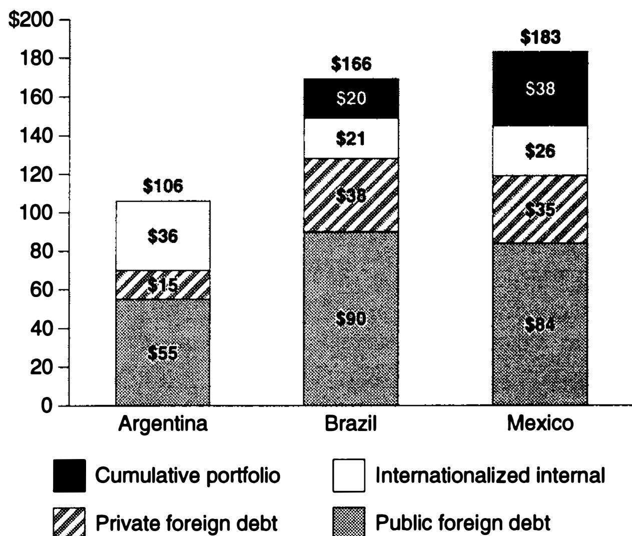
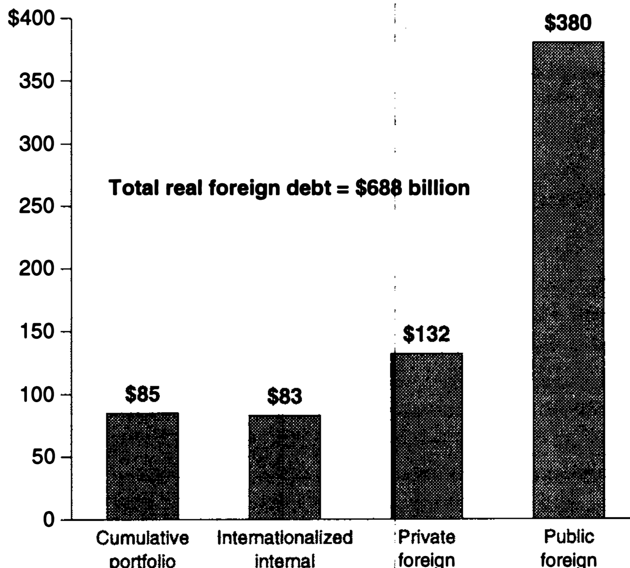


FIGURE 20
Ibero-America: real foreign debt, 1993
(billions $)



dollar of neighboring Argentina—and thus its internal cruzeiro debt is not now a foreign liability—all of that will change on July 1, when the "Real plan" is implemented. Closely paralleling the notorious Cavallo convertibility reforms of Argentina, which produced the skyrocketing of "internationalized" internal debt in that country, it is expected that the "Real plan" will quickly produce similar results in Brazil. The implications of this for the explosive growth of speculative obligations is evident.

For the continent as a whole (see **Figure 20**), this category of internationalized internal debt, estimated at $83 billion, adds 16% to the official foreign debt of $512 billion. Adding the conservatively estimated $85 billion in portfolio liabilities, Ibero-America's real foreign debt can be estimated as at least $680 billion. If accurate figures were available, there is little doubt that the true number would be closer to $750 billion.

Again, comparison with 1982 is instructive. The enormous run-up in debt from 1975-82 was a mixed bag: Some of the loans were definitely used for infrastructure, especially in Mexico and Brazil, and other productive investments, while some of it simply turned around and left as flight capital. But the financial assault in 1982 prevented any of the economies from realizing the full fruits of whatever useful productive investment had taken place to that point.

Today, the situation is far worse. Having, with the exception of Brazil, returned to a regime based on large current account deficits, new inflows are paying the service on previous inflows, just as in 1975-82, new loans paid the interest on the existing mass of loans. This is a classic "Ponzi"-type scheme, where early investors get paid their expected returns only from the proceeds of the paid-in capital of the most recent investors. The difference from pre-1982 is that far less of the capital flowing in is being invested in genuinely productive enterprises, and that the total obligations being created are now much larger than in 1982, around $750 billion, compared to about $330 billion in 1982. And, as mentioned, it is far more volatile. With most of the new money not in the form of loans, but in the form of hit-and-run speculative capital that can leave any time, countries can suddenly find themselves with not merely the evaporation of inflows, but with massive outflows that will wreck their financial systems virtually overnight.

The risk that this hot money represents was demonstrated in March and April in Mexico, when between $6 and $12 billion worth of these funds left the country, and the nation's reserves were drawn down by (at the most conservative estimate) over $6 billion to cover it. The flight was prompted by the combination of interest rate increases in the U.S. and the assassination of PRI presidential candidate Luis Donaldo Colosio on March 23. Its magnitude, over just a few weeks, proves just how volatile this money is. If Mexico has so far seemingly weathered the storm, it is only because it had sizeable reserves, and above all because the United States immediately announced that the Federal Reserve would back Mexico up to the tune of over $6 billion. Not only has the underlying problem not been addressed, but now the U.S. financial system itself is directly beholden to this foreign-based Ponzi scheme.