EIR Economics

Argentina Crisis: Wall Street Brains Are in Default, Too

by Dennis Small

Viewed dispassionately, the events of the last few months in Argentina's debt crisis leave the distinct impression, that the world's financial and political elite have "lost it." Bankers, international financial institutions, and entire governments scurry around, frenetically trying to convince each other that the corpse before them—Argentina's totally insolvent foreign debt of nearly $250 billion—is still alive and "performing."

U.S. Democratic Presidential pre-candidate Lyndon LaRouche recently remarked that this Argentine scene reminded him of the Edgar Allan Poe story, "The Facts in the Case of M. Valdemar," where M. Valdemar was hypnotized at the very instant he passed from life to death. For a period of time, the good gentleman kept up all the outward appearances of being alive—speech, locomotion, and so on—while all the while putrefying and decomposing on the inside. It merely typifies, LaRouche noted, the entire global financial system.

Last December, Argentina's debt was already so hopelessly non-performing that its Wall Street creditors had to be bailed out with a $40 billion package, put together by the International Monetary Fund (IMF), Group of Seven governments, and others. That bailout was dubbed "financial armor," and was touted as the final solution of all of Argentina's problems.

It didn't last six months. In June 2001, with Argentina at the edge of default, another bailout package had to be concocted, this one a $30 billion "mega-swap" which replaced high-interest, non-performing Argentine government bonds, with . . . *higher interest* bonds, with a *greater* total face value, which were even *more* non-performing than their predecessors! "We have beaten those who were betting against Argentina," was the irrational victory cry at the time of Economy Minister Domingo Cavallo—a PhD product of the Harvard Economics Department.

Six weeks later, in mid-August, Argentina was again in the default barrel. After 12 days of non-stop negotiations, which the world's financial media followed with morbid fascination, the IMF and Argentina's debt negotiator Daniel Marx gave birth to yet another implausible concoction. Backed by the meagre sum of $8 billion from the IMF—$3 billion of which won't even exist until an unspecified, new bond-swap scheme is put together in March 2002—the accord has two essential components:

1. An Argentine default will not be countenanced. Everyone has agreed to keep pretending that the putrefying corpse in their midst is alive and well.

2. The Argentina government of President Fernando de la Rúa has signed on the dotted line that it will implement a so-called "zero-deficit budget," starting immediately. We take these two points up, in turn.

Zero-Deficit Lunacy

Asked recently how he intends to avoid declaring a default this time around, Harvard PhD Cavallo waxed poetic: "It's like dropping an egg from 50 meters up, without breaking it." In an Aug. 27 address to 150 prominent Brazilian businessmen gathered at a plenary meeting of the São Paulo Commercial Association, *EIR*'s Brazil correspondent Lorenzo Carrasco retorted: "The problem is that Cavallo's egg is already 500 meters up, catapulted by the $40 billion bailout of December 2000, plus the $30 billion mega-swap, plus

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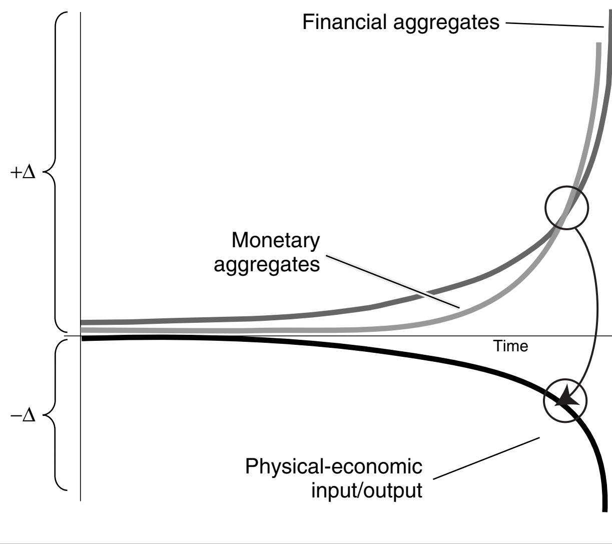
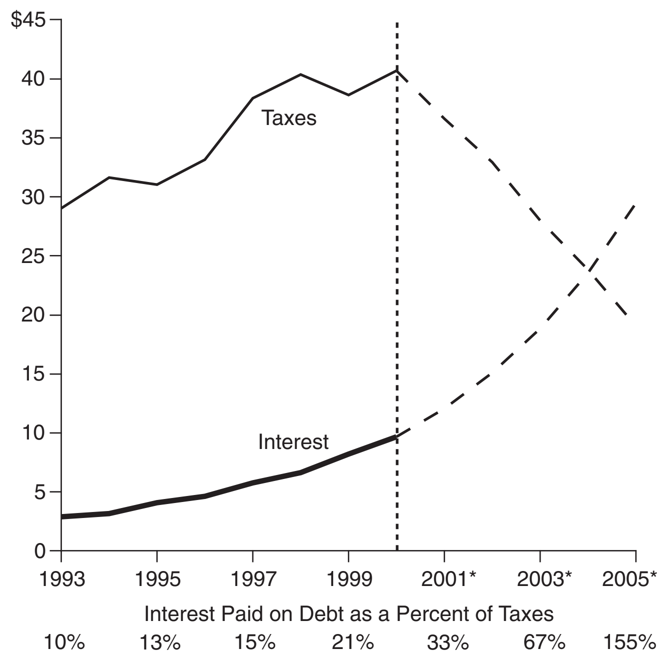
FIGURE 1
LaRouche Triple Curve, A Typical Collapse Function



The collapse reaches a critical point of instability.

FIGURE 2
Argentina: Taxes Collected vs. Interest Paid on Public Debt
(Billions $)



**EIR* projection.
Sources: Ministry of Economics, Argentina; *EIR*.

the latest $8 billion IMF bailout. If you add to that the growing pressures in Turkey, Brazil, Poland, and so on, there is no egg that can survive such a fall."

Indeed, Argentina's $250 billion foreign debt bubble, like the $400 trillion in global financial aggregates which it typifies, is *so* insolvent, that each effort to maintain that bubble with new debt instruments, requires a *net increase* in those instruments, which overtakes the total financial aggregates in existence. This zone of instability is best described by LaRouche's "Triple Curve" (**Figure 1**), and it is the zone in which Weimar-style *hyperinflation* is triggered and spins out of control. (See Richard Freeman, "Hyperinflation in Weimar Germany," *EIR,* March 24, 2000.)

Argentina, and the world financial system, have entered that zone.

But Wall Street's geniuses have not only unleashed a hyperinflationary financial process in Argentina; they have also triggered a second, simultaneous hyper*deflationary* process in the underlying real economy. This has been done by imposing what Cavallo has baptized as his "zero-deficit budget" solution.

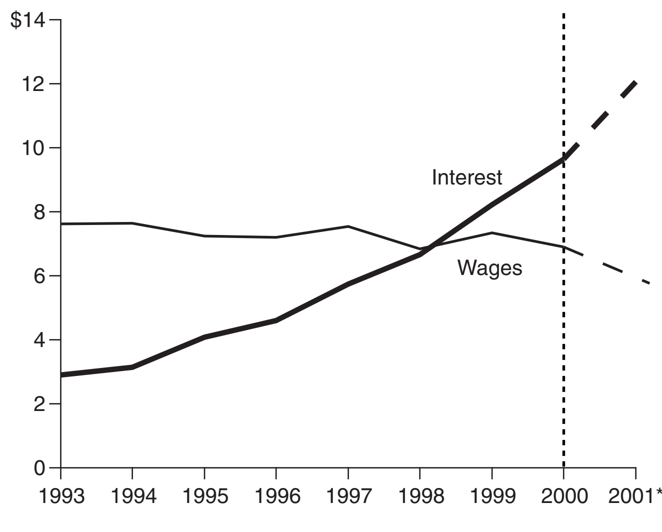
The concept is simple . . . and thoroughly incompetent. First, interest payments on the public debt are pronounced sacrosanct, and will always be paid, regardless of the consequences. Second, the government will only spend what it has left over from taxes and other revenue, *after* subtracting out its debt payments. In other words, the government will not run a deficit and borrow money to cover that deficit: Its deficit must equal zero at all times.

But what happens if interest payments keep rising, and tax revenues keep dropping, *as is now occurring in Argentina?* (See **Figure 2.**) What happens when interest payments take up 15% of the tax revenue (as already happened in 1997, despite the fact that taxes themselves rose sharply in that period, due to an increase in the value added tax from 12% to 21%)? What happens when interest payments hit 25% of tax revenues (as they did last year), leaving only 75% for all other government expenditures? When they hit a third of all tax revenue, as they will this year, will they still keep going? And when the soaring interest payments demanded eventually are *greater* than the entire contracting tax base—when the parasite is bigger than the host—what then?

In this fashion, a hyperinflationary debt payment process has been unleashed, along with a hyperdeflationary process of contraction of the real physical economy, which is causing a dramatic decline in tax revenues of 10% per annum, and more.

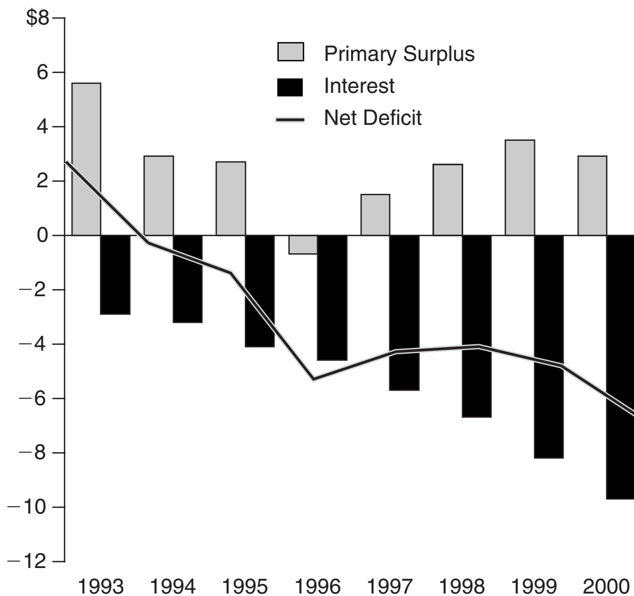
By holding to a zero-deficit budget under these contractionary conditions, Argentina is cutting sharply into all government expenditures other than interest payments. Health, education, and necessary national defense outlays are being demolished. And, as can be seen in **Figure 3,** wages of public

FIGURE 3
Argentina: Public Sector Wages vs. Interest Paid
(Billions $)



*EIR projection.
Sources: Ministry of Economics, Argentina; *EIR*.

FIGURE 4
Argentina: Government Budget
(Billions $)



*EIR projection.
Sources: Ministry of Economics, Argentina; *EIR*.

sector workers have been steadily declining since the early 1990s, by about 6-7% per year. In 2001, as part of the latest IMF package, public sector wages have already been cut by twice that amount, by 13%. But wages will be cut still further, if that is necessary to balance the budget—which it will be, because the collapsing economy is in turn shrinking the tax base.

For example, industrial production is now contracting at about 3% per annum, with the critical auto sector collapsing at the annual rate of 22%, over the course of the first eight months of 2001. Supermarket sales fell by 2.4% in the first half of 2001, and that worsened to a fall of 4.4% in July-August. Not surprisingly, in the first half of 2001 government tax revenues declined at the annualized rate of about 2.4%; but in July and August, tax revenues were officially falling by 7-8% annually. Informed sources in Buenos Aires have told *EIR* that value-added tax revenues actually fell by 17% per annum in August, but Cavallo pressured a number of foreign oil companies operating in Argentina to pony up future tax payments, in order to mask that dramatic fall.

Cut, Cut, Cut

Over the course of the 1990s, the Argentine government ran a continuous budget deficit, which in the year 2000 reached nearly $7 billion. The IMF, the U.S. government, international news media, and others, have all denounced this as evidence of Argentine profligacy. U.S. Treasury Secretary Paul O'Neill was perhaps the most boorish of the lot, when he remarked in mid-July: "They've been off and on in trouble for 70 years or more. . . . And they like it that way. Nobody forced them to be what they are."

These are, of course, all lies, as can be seen in **Figure 4.** The IMF has invented an accounting category called the "primary budget," which is defined as the total budget, excluding interest payments. Argentina has in fact run a primary budget *surplus* throughout the 1990s, but that surplus has been outrun by the greater, and rapidly increasing, schedule of interest payments. Over the last four years, interest payments on the public debt have risen by over 20% per year, on average. (In this study, we conservatively estimate that they would rise by about 25% per annum, from 2001 forward.)

This construct—of the need to run a large and growing "primary budget surplus"—has been used repeatedly to justify budget slashing, as well as the sale of government companies and other assets. This latter goes by the name of "privatization," and it was a significant source of additional government revenue throughout the 1990s. This culminated in a whopping $15 billion in privatizations in 1999, of which $2.6 billion entered that year's government budget, as a result of the sale of the national oil company, Yacimientos Petrolíferos Fiscales.

Now, however, Argentina has exhausted major assets