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The Big Gamble
Takinq a Huge Risk, Argentina Intentionally Deflates Its Economy

If It Keeps Currency Stable, It Will Be a New Model; If Not, It Could Be Mexico

Lower Wages, Higher Taxes

By MATT MOFFETT
and JONATHAN FREEDLAND

The WALL STREET JOURNAL TUESDAY, MARCH 21, 1995

Investors Look to Argentina

Argentina may be heading into a recession, but foreigners are betting on its economic future. Article on page A17.

Coping With Currency Attacks

Having already uncoined one of the most powerful economic expansions of the 1990s through an innovative scheme to peg the peso to the dollar, Argentina now could be establishing a new model for coping with speculative currency attacks in today's volatile global marketplace. If the measures fail, the country could succumb to the same pressures that forced Mexico to devalue its peso — with repercussions throughout the region.

"Mexico and Argentina were the star reformers, and for both of them to go down would set back progress toward free markets in all of Latin America," says Moises Naim, an analyst at the Carnegie Endowment for International Peace. Add the fact that Argentina is only two months away from presidential elections, in which President Carlos Saul Menem is seeking a second term to further his market reforms, and the stakes of Argentina's latest gambit are huge.

Positive Signs

Argentina's battered markets have recovered some lost ground as the government last week pieced together its plan of tax and tariff increases, budget cuts and nearly $6 billion in loans from multilateral agencies around the world. "Our hard experiences of the past convince us this is the road we must take," says Economy Minister Domingo Cavallo.

That road will only get rougher as policies to strengthen the peso pinch already hard-pressed manufacturing and service sectors. In the past two months, real-estate values in Buenos Aires have dropped 20%, and some auto prices are down as much as 10%. The country's largest car maker, Sevel Argentina SA, said it would scale back production at a plant four days a month due to falling demand. Farm-equipment makers also were rethinking it in the face of a 20% sales decline. Here in the capital, a local men's store ran a 30%-off sale; price tags are decorated by a stock-market graph in a downward diagonal.

In the incredible shrinking Argentine economy, wages also are trending downward. The government started the push a few weeks ago, trimming official salaries exceeding $2,000 a month and extracting a pledge from the country's most powerful industrialists to cut executive salaries by around 20%.

Pressured by the tighter economy, Hugo Speranza offered the 12 employees of his small-y¤ 200 (financing shop a choice. Either half of them would be laid off, or all would accept a wage cut of 10% and a reduction in food and transportation bonuses. Only two workers jumped ship.

"In difficult times like these, you are willing to live with a little less to avoid losing everything," says Pablo Sierra, one of those who remained.

Question of Confidence

Early returns on the Argentine austerity package were promising: Overnight bank-interest rates dropped to 10% from around 70%, while central-bank repurchase agreements, used by the government to provide life-sustaining cash flow to ailing lenders, also fell. Since then, both rates and repurchase agreements have moved slightly higher.

The biggest question about the government program is whether it will win the confidence of Argentine bank depositors. Since a handful of small banks went bust in late December after experiencing losses in their investment portfolios, a crisis of confidence in the banking sector has spread throughout the country. It has provoked an outflow of about $5 billion, or 12% of total deposits. Yesterday, a small bank in Argentina's Cordoba province, Banco Peigal, became the latest to suspend operations after losing about half of its deposits.

The unease is palpable on Florida Street in the heart of the financial district, where gawkers gather in front of an electronic board with the latest stock quotes, some fluctuating 25% in a single day. At the Citibank branch, there lately has been a rush of customers renting safe-deposit boxes, considered by Argentines to be more secure than savings accounts. A travel agent has been doing unusually brisk business on tickets to Montevideo in neighboring Uruguay, a financial safe haven where an estimated $1 billion to $2 billion in Argentine money has moved. A marriage broker to the professional class says some female clients are beginning to specify a preference for mates earning foreign currency.

Part of the blame for problems in the banking system lies in Argentina's vaunted currency convertibility, in which the peso is pegged one to one to the dollar and every peso in circulation must be backed by a dollar of hard currency reserves. "The central bank can't act as a lender of last resort," said convertibility prevents monetary authorities from printing new money without the hard currency to back it. Argentina's central bank can't pump liquidity into troubled banks as most central banks do; the problem was compounded by the government's failure in the years leading up to the current crisis to engineer a gradual shrinkage of the bloated banking sector, which included many undercapitalized and poorly managed institutions.

While only a few banks have failed outright, perhaps one third or more of the country's 19,000 institutions have effectively ceased to operate in the past three months, according to Christopher Bocestone, Buenos Aires-based analyst for a Mexican brokerage firm Interacciones SA. Several have been absorbed in mergers, and many more survive as what Mr. Bocestone calls "zombie banks." Institutions existing only to liquidate portfolios and to call in loans to pay off depositors.

Sacrifices for Stable Currency

While some Argentines have panicked, others seem inspired by a kind of financial patriotism. A group of local industrialists met with President Menem last week and pledged to subscribe to a $1 billion bond issue that the government must place to balance its budget. And there have been smaller, more spontaneous gestures: An engineer named Juan Carlos Fernandez, 24, wrote out a check to the Argentine government for $10,000 and called on 199,999 others to match his contribution.

"To understand why Argentina will sacrifice so much for currency stability, you have to think like a German rather than an American," says Manuel Sacerdote, president of Bank of Boston's local office. "The U.S. lived the Great Depression, so it fears recession. Germany lived hyperinflation, so it's scarred of inflation."
What's News—

Business and Finance

NASDAQ PROPOSED a new sys-
tem for handling small-investor
orders, an attempt to dispel criticism
of the market's trading practices.

The new system isn't expected to
readily respond to an anti-trust
charge against the Big Board. The plan
is subject to approval by the SEC, which
blocked an earlier Nasdaq proposal.

E.W. Scripps is considering selling
all or part of its cable systems, which
analysts said could bring up to $1 bil-
lion. Scripps said other options include
acquiring more cable operations.

Stock prices climbed to new highs
once again as the dollar rose and bond
prices eased. The Dow Jones Industrial
Average gained 10.03 to 4683.68.

Consumer Reports magazine, in its
widely followed auto issue, is taking
Chrysler to task for reliability prob-
lems, sharply criticizing some of the
auto maker's top-selling models.

Circus Circus shares jumped 14%
on the company's plan to acquire
closely held Gold Strike Resorts, re-
flecting investors' optimism about the
combined companies' growth pros-
pects and strong management team.

The Clinton administration is con-
sidering consolidating the govern-
ment's economic-statistics agencies.

Morrison Knudsen disclosed
larger-than-expected losses for the
fourth quarter and full year, and said
that its acting chairman resigned.

The U.S. is investigating whether
the finance units of the Big Three U.S.
auto makers have discriminated
against minorities by charging higher
interest rates on car loans.

The FDA approved Medtronic's
next-generation heart defibrillator.
The company's shares rose 3.5%.

Chevron hopes to sell its real estate
development businesses, a move that
some outside developers believe could
raise several hundred million dollars.

UAL said 1995 costs are lower than
expected, prompting some analysts to
increase their earnings forecasts.

Cadillac Fairview filed a new debt
restructuring plan that leaves subordi-
nated debt holders, mainly U.S. inves-
tment funds, with a smaller stake in
the Canadian real estate concern.

Playtex will sell a 40% stake to a
group led by Dallas investors Haas
Wheat & Harrison and said Chief Ex-
ecutive Joel Smilow will step down.

world-Wide

POLICE BEGAN a massive probe of a
nerve-gas attack on Tokyo subway trains.
The attack killed eight people and sick-
ened nearly 4,700, but no clear suspects or
motive have emerged. Tokyo police mobil-
ized 300 detectives to investigate the case.

Authorities said at least five unidentified
suspects left various containers filled with
nerve gas throughout the city's subway system.
A U.S. official said it was prepared to offer technical assistance to
Japan. (Articles on Page A3 and A12)

New York City transit police were
placed on alert yesterday, but generally
subway authorities remained confident
that preventing such an attack
was nearly impossible and had made
no decisions on new security measures.

GOP SENATORS INTRODUCED their
own revised line-item veto bill.

Instead of vetoing the president strike
items from a bill, the measure, offered last
night, gives Congress a system under which indi-
vidual sections of future tax and spending
legislation would be sent to the president
separately and be subject to a separate veto.
The bill would subject future tax bills to
the same section-by-section line-item veto struc-
ture. Clinton issued a statement urging the
Senate "to pass the strongest, possible line-
item veto, and to make it effective immedi-
ately." But the White House, under pressure
from Democratic allies, hasn't spelled out
exactly what version of the bill it wants.

Republican senators immediately
challenged Clinton to produce the half-
dozon votes from his own party that are
needed to head off a Democratic filibuster
on the measure.

Clinton will go to Moscow in May to mark
the 50th anniversary of V-E Day. He will hold discus-
sions with Yeltsin on issues including the
war in Chechnya, Russian economic
reform and the future of Nato. Clinton's
trip will include a visit to Kiev to meet with
Ukrainian President Leonid Kuchma.

Heavy fighting broke out in central Bos-
nia and the strategic Tuzla region. The
Muslim-led Bosnian Army launched a major
offensive, rocking an already shaky cease-
fire and sparking a stiff Serb response. Nineteen people were reported killed and
dozens wounded in the northern govern-
ment-held city of Tuzla.

OSHA issued a draft proposal rules on
repetitive-stress injuries, but played down
the scope of the changes in an attempt
for stem GOP criticism. The draft comes days
after the House voted to cut OSHA's budget.

An OSHA official acknowledged the draft is
less aggressive than a version prepared in
June. (Article on Page B4)

Republicans plan to focus part of a
farm-bill debate on how to revamp a farm-
loan program that has lent funds to farmers
without enforcing repayment. Under Clini-
ton, the GOP complaints, the Farmers Home
Administration has become even more lax,
particularly toward wealthy delinquent bor-
rowers. (Article on Page A22)

The U.S. plans to endorse former Italian
trade minister Renato Ruggiero today to
head the new World Trade Organization, all
but assuring his selection. The move ends
months of fighting between the U.S. and the
EU. The EU has agreed Mr. Ruggiero will
serve four years, and will be followed by a
non-European. (Article on Page A22)

Russia attacked NATO plans to take in
former Communist states, as more than 50
European nations approved a stability pact
aimed at overcoming the Cold War's legacy.
Russia's foreign minister Andrei Kozyrev
said that greater efforts should be made to
include all nations in security structures.
The Big Gamble: Argentina Takes Huge Risk of Deflating Economy

Like Germany, Argentina remembers a sobering bout with hyperinflation, the culmination of 50 years of economic mismanagement that by the early 1990s had gutted what once was the world's seventh-largest economy. When Dr. Cavallo took charge of the economy in 1991, inflation was running at an annual rate of 2,000%, supermarkets were being looted and electrical utilities were providing power only a few hours a day. Since Argentines were abandoning the local currency and conducting transactions in dollars anyway, Dr. Cavallo decided to formalize the system by pegging the currency to the dollar and giving Argentines the option of using either currency. Almost immediately, inflation eased, and the economy embarked on an expansion surpassed only by China's during the 1980s.

Any shortcomings were obscured by the incoming flood of foreign capital, which sent Argentina's stock-market capitalization soaring 15-fold to $45 billion during the first three years of convertibility. A new class of self-made multimillionaires emerged. Typical was the group of youthful, street-smart real-estate executives who teamed up with Hungarian financier George Soros to buy a moribund Buenos Aires real-estate company for $110 million. On Dec. 19, they were able to raise $130 million for an initial public offering on the New York Stock Exchange.

As it happened, the day after the offering, Mexico devalued the peso and a host of developing nations were battling to protect their own currencies ever since. Two weeks ago, Spain devalued, surrendering to the speculative pressures that did in Mexico. Brazil, despite ample foreign-currency reserves and strong export earnings, also has devalued its currency as a preemptive move.

But in Argentina, the notion of giving up the fixed exchange rate was pondered only in a disaster scenario. The government had too much credibility riding on the dollarized currency scheme, and the Argentines had too many bad memories of previous devaluations. "For the first time in this country's modern history, there isn't any sector of the economy asking for a devaluation, not exporters, not the unions, not the left, not anyone," says Jorge A. Heinze, executive director of Banco Roberts, one of Buenos Aires's largest banks.

Depending on Private Sector

In many respects, convertibility has withstood the crisis just as theoreticians predicted it would. With capital inflows evaporating, the country's trade deficit was down sharply in both January and February and may shift into a surplus in March. Inflation last month was zero, and authorities expect deflation in March.

But now it will be up to the private sector to provide the foreign exchange needed to support the peso—and there lies the rub. In order to obtain the funding that the government can no longer raise on capital markets, Dr. Cavallo has cut export subsidies, raised import tariffs and shifted more of the onus of paying social-security taxes to companies.

Says University of Maryland economist Guillermo Calvo: "The problem is, they are tax ing the private sector. If there isn't enough flexibility, they fall into a depression, which in turn makes it much more difficult for companies to refinance their debts. That, in turn, jeopardizes the health of the financial system."

Oswaldo Frota, owner of a personnel-placement firm, has a window seat on the private sector's unease. Thanks to layoffs and increased competition for job openings, he needed only one morning to find candidates for 30 office positions that would have taken a week to fill before this year. The problem Mr. Frota has is getting paid these days. The total of past-due accounts has swollen to $250,000 from none three months ago. And his job requires an increasingly delicate touch. He is doubling the length of the half-hour interview he uses to conduct routine psychological profile. "The first half-hour," he says, "you just have to get people to calm down."

Dr. Cavallo is betting that, despite its high anxiety, the private sector has become sufficiently competitive to handle the increased fiscal burden. In the first three years of convertibility, manufacturing productivity increased by 42%, according to a study by economist Miguel Broda. Nonetheless, Argentina remains largely dependent for its export earnings on oil and a handful of agricultural products, like wheat and beef, and there is only so much that productivity gains can do in the face of fluctuating prices for exports.

That is one big reason why so much emphasis is being put on wage cuts, particularly in Argentina's bloated white-collar workforce. One study showed that Argentine executives had the highest wages in nominal terms of any country in the region. Even when adjusted for differences in purchasing power, Argentine executives earned more than their peers in the U.S. There is no guarantee organized labor will buy into Dr. Cavallo's effort to engineer deflation. So far, leaders of the country's still powerful union movement haven't been openly critical, but that could change, particularly as elections approach.

For the moment, though, Argentines seem united in fighting devaluation. Dr. Cavallo led a call to arms at a recent meeting with 50 business leaders. But government officials themselves could scarcely conceal their worries about when the crisis of economic confidence would abate. Mr. Menem's vice-presidential running mate, Carlos Ruckauf, spoke with candor about a dilemma many Argentines are experiencing: "My wife asked, 'What do I do with the money in the bank?' " he told the crowd.Passing theatrically, he related his response: "I said, 'Leave it.'

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Emergency Measures

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Source: Economy Ministry
Suspected Toxic Agent in Attack Is Made Of Chemicals Easily Available in U.S.

BY ROBERT S. GREENBERGER
AND JERRY E. BISHOP
Staff Reporters of THE WALL STREET JOURNAL

Sarin, the suspected toxic agent that wreaked death and havoc on Tokyo’s subway system, is made from chemicals readily available in the U.S. or in practically any other agro-industrial society.

The raw material is chemically akin to common organophosphate agricultural pesticides. Mixing the deadly brew requires care, skill and a reasonably well-equipped lab, but probably could be done by someone with a working knowledge of chemistry. Sarin is also easy to transport without much fear of detection.

“I think a college graduate with a major in chemistry could easily develop the capability to make this type of material,” says retired U.S. Army Maj. Gen. Gerald Watson, who spent 30 years in the Army’s chemical corps.

Indeed, it is the chemistry that makes this incident different. U.S. officials and private terrorism experts have discussed for more than a decade the nightmare scenario that extremist groups might use chemical or biological weapons. One such incident—in what might have been a macabre dress rehearsal—occurred in Japan last June, when Sarin, apparently killed seven people in their houses in Matsumoto. For the most part, however, terrorists have preferred to use biological weapons because they are easier to handle and create the kind of damage that has more shock value on television.

Genie Is Out of the Bottle

But now, “no matter who did this, an important psychological threshold has been crossed,” says Bruce Hoffman, director of the Center for the Study of Terrorism and Political Violence at St. Andrews University in Scotland. “There have been indications over the past 20 years that terrorists have been talking about this, but now the genie is out of the bottle.”

“Terrorists have been talking about this for more than a decade,” adds a Clinton administration official who is involved in counterterrorism efforts.

Over the past decade, the U.S. has built a sophisticated system to detect terrorists, including monitoring equipment at airports and dogs trained to sniff bombs. But none of that infrastructure would detect Sarin, which can be transported in a glass container, experts say.

Chemical Weapons Treaty

Further, the appearance of this potentially new threat comes as many nations are moving toward approving a treaty to eliminate their stocks of chemical weapons. Ironically, the decadelong negotiations over this Chemical Weapons Convention has brought about a proliferation of articles published by governments and scientists who support eradicating such weapons. Many of the articles include the chemical recipes for poisons. In recent years, much of the material has turned up on computer databases worldwide, experts say. “We’ve published a Betty Crocker kind of cookbook of how to do these things,” says Frank Cox, a retired U.S. Army colonel who was a specialist in chemical weapons.

Sarin, developed in Germany between the two world wars, belongs to a class of chemical pesticides that do their dirty work on humans as well as insects by fouling up the functioning of a chemical that transmits electrical nerve impulses. Specifically, acetylcholine is the chemical that relays nerve impulses to the muscles, glands and other organs. Once the impulse is sent, an enzyme comes along and destroys the acetylcholine to make room for a new impulse to be relayed. Sarin interferes with this normal destruction of acetylcholine, causing excessive amounts of acetylcholine to build up at nerve junctions.

“Sarin was designed to kill people and it does a pretty good job of it,” says toxicologist Brian Schwartz at the Johns Hopkins School of Public Health in Baltimore. “The main problem comes with excess acetylcholine building up at the junction of the nerve with muscle,” he explains. “This leads to flaccid paralysis of the muscles.” When the paralysis reaches the muscles that do the breathing, death occurs.

Gen. Watson speculates that one reason relatively few people died in the Tokyo subway attack is that the terrorists may have diluted the mix for their own safety in handling it. Sarin can kill by either inhalation or by absorption through the skin. “One drop on the skin can kill you,” Dr. Schwartz says. Far less can be fatal if inhaled.

Gen. Watson says that whoever transported the Sarin to the subway system probably brought it there in a glass container, which is effective and relatively safe, because glass won’t corrode. Sarin, which is a liquid, could have been released into the air either by opening the container or by crushing it.

Regardless of who launched the attack, or what the motives were, the incident was “a quantum leap,” says Mr. Hoffman with the Center for the Study of Terrorism and Political Violence. “You have a group sophisticated enough to carry out a simultaneous attack like this and sophisticated enough to handle this stuff.”