Chapter 5: Argentina (Raw Material)


INTRODUCTION

Argentina as an example of the failure of the neoliberal model. [?

Argentina as an extreme example of the dangers of globalization; the country collapsed. Financial crisis after the collapse of the convertibility plan.

Since the early 1990s, this country incarnated the most radical application of neoliberalism in the region and provided the best example of a harmonious partnership among the IMF, the World Bank, and the national government. [Lopez-Alves 2007, 49].

In the case of Argentina, the “payoff” for being the poster child for the neoliberal agenda of the so-called Washington Consensus was the unprecedented total collapse of its economy, which pushed more than 50 percent of the population below the national poverty in 2002. [Harris 2008, 89].

Countries depend on the global markets, high levels of vulnerability.

The case of Argentina: from the Austral Plan to the convertibility plan to the crisis and the recovery.

The price of price stability: the challenge of resolving the social deficit. The social cost of stabilization has been poverty and inequality.

Critics of globalization saw the Argentine crisis as a confirmation of their skepticism towards the “Washington consensus”: economic integration [globalization] intensifies socio-political conflicts because it is mainly the owners of capital and export industries that benefit from the renunciation of ISI.

Argentina will be anything but typical of Latin America.

What caused the economic disaster in Argentina?
The Argentine social and economic crisis as a symptom of a larger LA crisis.
Causes of the crisis: a combination of economic, political, external and internal reasons [ a case of intermestic politics]: vicious circle of external shocks, domestic vulnerabilities, currency appreciation, economic policy mistakes, and problems of governance.
Restrictive monetary policy badly implemented, and bad luck.
Vulnerability in the international financial and capital market.
Fiscal (over)spending.
Argentina’s vulnerability: fiscal accound and competitiveness, external shocks?
Crisis.
Beatriz Nofal

Argentina has experienced the worst economic crisis ever (3/4 GDP fell). Recession, depression, financial crash, staggering social results: 50% below poverty line.

Causes of the crisis: combination of economic, political, external and internal reasons: vicious circle of external shocks, domestic vulnerabilities, currency appreciation, economic policy mistakes, and problems of governance.

External shocks included no capital flows, devaluation of the Brazilian real; change of policy in Washington regarding economic aid (financial assistance, attitude not to assist in November 2001).

The Argentine economy has rebounded after the crisis, but it is very precarious: need for a new constitutional government, political reform, and a sustainable economic plan: fiscal solvency and strengthening of the financial system.

The credibility of the Argentine foreign policy has diminished because of dismal economic crisis and lack of reciprocity from the USA.

People blame corruption and other evils for the terrible Argentine crisis, but what about the international economic structure? [importance of the context] [comment by Shlomo Griner].

Neo-liberal restructuring as a result of distributional competition and interest bargaining.
After 2001, recovery and return to a mild ISI.
Before 2001: Use finance to stabilize and manage the national economy: an alliance between the state and transnational power at the expense of the local industry.
A case of financial dependence, financial globalization: the state depends on private actors in terms of its authority.
A. THE HISTORICAL CONTEXT, 1982-2008

1. Historical waves of globalization and poverty in Argentina

*Domingo Cavalho (Interview, June 12, 2008):*

Poverty until 2001, because of unemployment.
Poverty after 2002, because of the devaluation of the peso.
In general, one can argue that globalization improves the standard of living of the developing world [at the expense of the lower classes in the developed world].
The Argentine experience:
Argentina opened itself to the world, without inflation: positive impact upon the workers, yet, the migration from neighboring countries led to competence in the informal sector, the salaries went down. Argentina benefited vis-à-vis the USA and Europe, but it hurts itself vis-à-vis the most poor countries in the region.

A positive effect of globalization: economic stability: financial globalization, need to discipline the monetary policy.

Financial liberalization leads to a surplus of credit: abusive debt by the provinces.

The financial crisis carries terrible consequences: unemployment and poverty; capital flight, no investments.

Chronology of the Argentine economy in an age of globalization:

2) 1994-1995: tequila crisis in Mexico;
3) 1996-1998: economic recovery;
4) 1998-19999: economic crises in South Korea (1997), Russia and Brazil (1999), affected negatively Argentina, led to recession, the provinces had debt, financial markets downgrade the Argentine ranking, unemployment and poverty.
   (1) 2001: economic and political crisis, huge devaluation, evanescence of the middle class.
The crisis is not a direct result of globalization.
A2. The Debt Crisis of 1982 and the Lost Decade of the 1980s

When in the late 1970s and early 1980s the United States raised interest rates to nearly 20%, Argentina found itself unable to meet its debt repayments. Debts were restructured, but there was inadequate debt forgiveness, and for much of the 1980s money flowed from Latin America to the United States and other advanced industrial countries. Latin America stagnated. [Stiglitz 2007, 220-221]
A3. The 1990s [Menem]: Neo-Liberalism and the Washington Consensus

Argentina had an episode of very high inflation at the end of the 1980s, hitting a peak annual rate of 3,080 percent in 1989; to fight inflation, the country pegged its exchange rate to the U.S. dollar. The strategy worked: inflation came down. But it was a risky strategy; a volatile international economy requires frequent adjustments of exchange rates, which Argentina's new economic regime did not allow. The consequences would unfold over the next decade. [Stiglitz 2007, 221].

With the burden of debt lifted, for a while, in the early 1990s, Argentina had a boom. New confidence in the economy meant that banks and other lenders were willing to lend, even to finance consumption. Foreigners were encouraged to lend to Argentina, as the IMF continually singled out the country, praising it for its low inflation and other policies that were in accord with its advice. [Stiglitz 2007, 221]

But suddenly, Argentina's fortunes changed. The precipitating event was the East Asian crisis in 1997, which by 1998 had become a global financial crisis. Global interests to emerging markets soared. Largely as a result, Argentina's debt service increased from $13 billion in 1996 to $27 billion in 2000. These problems were compounded by the strong dollar; since the Argentine peso was tied to the dollar, it was increasingly overvalued. [Stiglitz 2007, 221].

Carlos Menem (1989-1999) abandoned the banners of Peronism, adopted in full the reform and re-adjustment program, applying it in its simplest, most brutal and destructive form: an unrestricted financial opening to international markets and a completely reckless privatization of state companies. [Romero 2004, 30]

Menem's initial success, which he shared with his economic minister, Domingo Cavalho, coincided, as in 1978, with a period of great influx of foreign capital into the country. He thus managed to stabilize the peso, pegging it (under the Convertibility Law) to a dollar that was flowing in freely. But what should have originally been a disciplined and fiscally austere program turned out to be, due to the inflow of volatile capital, a generous sharing of profits, which succeeded in melting away possible opponents and even benefited broad sectors of the middle class. As in 1981 and 1989, the end of the easy influx and the withdrawal of speculative capital, which had started to be noticeable in 1997, marked the limit of Menem's success. The predictable collapse fell on his successor's shoulders, De la Rua (1999-2001), whose last minute economic measures (the corralito on bank deposits) unleashed the monetary crisis of 2002. [Romero 2004, 30-31]

Under IMF directives, less than three years after the first steps toward liberalization were taken during the first Menem administration, Argentina became the economy hosting the highest foreign investment and the largest number of foreign-owned firms in the whole of Latin America. [Lopez-Alves 2007, 55]

Interview with Alexandre Roig, economist, September 27, 2004

Background to the economic model of the 1990s, as a form of economic discipline, understanding of the social background, against the background of hyper-inflation in the recent past; support of the national bourgeoisie and transnational links; not
completely coherent (does not favor exports); pegging 1 to 1 to the dollar; not a very feasible policy. It encourages unemployment. [The fiscal explanation is not completely valid, corruption is not a problem, but capital flight is a serious problem]. The pegging is maintained by the influx of capitals: FDIs: privatization in 1995-1996; also increase in the external debt from 1995 to 2001; from 90 to 180 billion of $; starting 1996, unemployment, poverty and inequality. The convertibility plan is kept in place. The end of the 1990s: parallel monetary systems in the provinces; the crisis explodes in 2001.

Each one of the five years between 1999 and 2003 constitutes a chapter on its own in the history of the crisis. During 1999 Argentina suffered a moderate recession (-3.4 per cent), largely attributable to external shocks: the devaluation of the Brazilian currency in January, the strengthening of the dollar (and thus, the peso) against major currencies, the flight to quality of international capital – all contributed to the fall in real activity. [Llach 2004, 44]

In December 2000 the De la Rua administration negotiated a substantial package of external help so as to be able to postpone fiscal adjustment for the future. Then financial markets panicked.

In March 2001 the Argentine financial system suffered the most intense outflow of deposits in the whole decade of convertibility. [Cavalho's appointment did not help] [Llach 2004, 45].
A4. The Great Crisis of 2001-2002

With fewer exports and more imports, Argentine's balance of payments deteriorated, and it had to borrow more abroad. There began a vicious circle in which the IMF played a critical role. As global interest rates increased, Argentina's loan payments increased, so its fiscal deficit increased. The IMF, focusing on the deficit, demanded tighter fiscal and monetary policies: increasing taxes, cutting expenditures, and raising domestic interest rates. These had the predictable effect of lowering Argentina's output – and tax revenues. [Stiglitz 2007, 222]

That which is not sustainable will not be sustained; and Argentina's high exchange rate and mounting debt was not sustainable. Finally, in late 2001 and early 2002, the country's economic crisis came to a head; it defaulted on its debt – it simply did not pay what was owed – and let its exchange rate float. The value of the peso quickly fell by a third. In the economic chaos that ensued, the official unemployment rate soared to over 20 per cent, and GDP fell by 12 percent. [Stiglitz 2007, 222].

Preface to the Crisis [Shambaugh]

(1) 1994: The Mexican peso crisis (“Tequilla crisis”): The investments left Argentina but they came back after eight months, Argentina survived the crisis. It was considered a successful example until 1998. This was the “golden era”. But there were problems: (1) the quality but also the prices of the services went up; (2) unemployment; (3) there were winners and losers.

There were two dubious processes taking place: Menem effectively coopted labor, corruption, no labor protest, no anti-globalization movement; inflation was lower in the USA than in Argentina, so Argentina became less and less competitive, increase of unemployment.

(2) Decline of liberalism, 1999-2001: Surge in the outflow of capital: cashing out the benefits of globalization, although most people maintained their accounts in $ or pesos; there is a hidden inflation in Argentina, the peso is over-valued, imports are trumping exports; increasing high levels of unemployment: 14% to 24% in 2001, globalization is good for “some,” not for all.

In 1998 there is already an economic crisis, expensive exports to Brazil, runnout on the currency: local bonds, tying the fate of any individual to the country. Problem: how do you get money? The whole system spirals out of control. Politically there was a problem in changing the currency system, it will increase the debt.


Argentina actually suffered multiple crises during the 1990s, first early in the decade and then again starting in 1999.
Argentina’s inflation in 1990 reached more than 2,300 percent, and the population obviously yearned for some relief. This came in 1991, when the Economy Minister, Domingo Cavalho, introduced Argentina’s convertibility system precisely to choke off the inflation. [Weintraub 2003, 117]

The system worked – for a time. Inflation came down and remained low until the peso devaluation, and GDP grew sharply by an annual average of 5.8 percent between 1991 and 1998. But then problems began to emerge. The current account deficit rose to 4.2 percent in 1998, and fiscal deficits were quite consistent from 1995 on. [Weintraub 2003, 118]

Even during the good years of the mid-1990s, when GDP growth was substantial, Argentine unemployment remained high, in the range of 12 to 15 percent of the economically active population. The low inflation was extremely popular, which explains the reluctance to tinker with the exchange rate. [Weintraub 2003, 118]

The evidence is that the rigidity of convertibility, in concert with the limited monetary flexibility of the currency board structure, lasted too long. [Weintraub 2003, 118]

Argentina not only had the rigidity of convertibility, but it entered into what it hoped would become deep economic integration with Brazil. Argentina’s exports to Brazil increased dramatically and reached about one-third of total exports. Then came the Brazilian devaluation of 1999, and the incompatibility of the two exchange-rate systems became manifest. [Weintraub 2003, 118-119]

When Cavallho returned as economy minister in 2001, he took a number of measures to avoid both outright devaluation and debt default.

Argentina’s recession began in 1999 and worsened as Brazil’s currency depreciated further in 2001, making the mismatch between the Argentina exchange rate structure and the Brazilian more evident than ever.

The dismal economic situation, coupled with what was seen as the ineptitude of the government, led to the resignation of President Fernando de la Rua in December 2001. [Weintraub 2003, 119]

Between December 21, 2001 and January 1, 2002, the country had no less than five presidents, setting a questionable record. [Klein 2004, 2-3]

There was a widespread feeling, if an ill-defined one, that the people had been let down by the entire political class, los políticos. [Klein 2004, 3]

Given the depth of the crisis, and the public disparagement of, and hostility towards, the political elite and the political institutions that it caused, it was remarkable that Argentine democracy survived at all. [Klein 2004, 5]

The Argentine crisis broke out in the last months of 2001 and intensified during the course of 2002, when bank deposits were trapped in the corralito and massive demonstrations against the political establishment, summed up in the clamorous demand Que se vayan todos! (Everyone must go!) made international headlines. In
the last third of 2002, the realization that a final collapse was not imminent, the
perception that the state had some sort of capacity for negotiation and, above all, the
prospect of the presidential election eased the tension somewhat. The elections of
April 2003 came as a surprise because of the high level of attendance and the careful
use of votes, distributed among several candidates. [Romero 2004, 15]

The Argentine crisis has a disconcerting singularity: in the last twenty years there has
been a curious co-existence of two processes, which are, at first sight, contradictory.
One of them is the decline of the state and the impoverishment of society. The state
seems to have reached a point of liquefaction, with no resources at its disposal, no
management tools, corrupt to the marrow, limited by foreign debts and tied down by
powerful corporate interests. Because of the high levels of unemployment, half of the
Argentine population is living in poverty, in a state of abject destitution. This
situation differs greatly from those times when Argentina had a strong state and a
mobile an egalitarian society. [Romero 2004, 15-16]

The second process is of a political nature. Paradoxically, it was in this "exhausted"
Argentina that, for the first time in its history, a political democratic regime was built,
formally correct, republican and pluralist, and similar to countries with more
consolidated democracies. [Romero 2004, 16]

The cataclysm took place at the end of 2001: a run on the banks, the freezing of all
deposits, and an asymmetric devaluation. Parallel to the social protests the political
crisis unleashed by the Peronist governors finally led to the president's resignation.
[Romero 2004, 35]

The crisis manifested itself in several ways: the lack of a national currency and the
proliferation of provincial bonds of dubious value, and the questioning of business
agreements. There was growing insecurity, a rise in crime, and a questionable judicial
order. The 2002 crisis put an end to the illusion of convertibility and created the
conditions that would allow for Argentine problems to be viewed in a mature way.
[Romero 2004, 35]

Argentina's economic crisis involved the deepest peacetime fall in GDP suffered by
any capitalist country of some significance at least since World War II. In four
consecutive years of recession (1998-2002), national income fell by a total of almost
20 percent. [Llach 2004, 40]

Martin Feldstein (2002), "Argentina's Fall: Lessons from the Latest Financial Crisis"

Although Menem's reforms are not responsible for the current chaos, they are a
politically convenient scapegoat. [Feldstein 2002, 8].

**Pegged all wrong**

An overvalued fixed exchange rate (locked at one peso per dollar since 1991) and an
excessive amount of foreign debt were two proximate causes of the Argentine crisis.
Because the exchange rate was fixed at too high a level, Argentina exported too little
and imported too much. This trade imbalance made it impossible for the country to
earn the foreign exchange it needed to pay the interest on its foreign debt. [Feldstein 2002, 8]

Once it finally became clear that Argentina could no longer borrow to roll over those debts and pay the interest, Buenos Aires was forced to default and to devalue the peso. [Feldstein 2002, 9]

The reason Argentina retained its fixed exchange rate too long is fairly simple: such a peg had cured hyperinflation at the end of the 1980s and brought a decade of price stability that provided the framework for strong economic growth. [Feldstein 2002, 10]

Argentina went further than any other country, when it enacted a "convertibility law" that pegged the peso to the dollar at one-to-one exchange rate and stipulated that everyone had the right to convert as many pesos to dollars as they wanted. The fixed exchange rate could have succeeded, however, only if the peso became competitive enough to generate more exports than imports. [Feldstein 2002, 10].

Cavallo correctly foresaw that the combination of low inflation and market liberalization would lead to a rapid growth of productivity. Although this was sufficient at first to lead to both rising real wages and increased international competitiveness, eventually rigid labor laws and strong union pressures prevented the further reduction in production costs that Argentina need to become competitive. [Feldstein 2002, 10-11].

**Pressure Building**

Wage increases kept the cost of production in Argentina high, depressing exports and encouraging imports. Argentina's competitiveness worsened as the dollar strengthened relative to most other currencies, pulling the peso up with it. [Feldstein 2002, 11].

The terms of trade also moved against Argentina, with world prices for its exports declining, relative to the prices of its imports. But the biggest blow to Argentine competitiveness came when Brazil's currency, the real, fell sharply in 1999. [Feldstein 2002, 12]

The inevitable result was increasing current-account deficits, which reached nearly five percent of GDP, and therefore mounting foreign debt. There were also substantial deficits in the budgets of the central and provincial governments. These budget deficits were due to widespread tax evasion and to an inability to control government spending, particularly at the provincial level. [Feldstein 2002, 12].

As the debt grew, the interest rate that Argentina had to pay foreign creditors also rose, further increasing the annual imbalance and accelerating the growth of the foreign debt. Default became unavoidable. When Argentina finally defaulted on $155 billion of central and provincial government debt in December 2001, it was the largest sovereign debt default ever. [Feldstein 2002, 12]
Peg headed?

(…) the peso was devalued sharply in January 2002.

What was the role of the IMF in all of this? Critics of the fund charge three things: its staff did not adequately warn Argentina of the danger of its policies; it forced Argentina to adopt contractionary policies that led to three years of recession before the crisis hit; and it encouraged the continuation of bad policies by providing a series of large loans. [Feldstein 2002, 13].

The real problem with the IMF "conditionality" in Argentina is that it did not achieve the changes that were really needed, especially the changes in such things as the constitutional revenue-sharing rule and the level of provincial spending that continued to contribute to the budget deficit. [Feldstein 2002, 13]

The IMF and Argentina

Argentina's crisis exploded with a debt default and peso collapse in December 2001. The IMF, judged by the size of its funding programs, their inappropriate policy strategizing, and lack of innovative sequencing, had proved inadequate to the challenges Argentina posed. [Desai 2008, 300-301].

The IMF adopted its standard funding package and fiscal austerity, and watched the Argentine authorities implement it via disorderly debt restructuring and escalating budget tightening while remaining in the grip of the destructive peso-dollar link. [Desai 2008, 302]

What stood in the way of an early restructuring of Argentina's debt? Standing at approximately US 133 billion $ by the end of 2001, Argentina's debt had moved up in relation to GDP from about 50 percent in mid-2000 to 60 percent a year later, as economy continued to decline and interest charges accumulated. [Desai 2008, 302].

[Otto Reich, US-Latin American Relations] (Georgetown, October 21, 2002)

Argentina is a wealthy country. Its financial system has collapsed (unlike Mexico). They have to rebuild their banking system; people are bartering, like five hundred years ago.

The IMF has identified fourteen steps for the Argentines to put their economic house in order: the economic contraction in Argentina is twice as much as that of the Great Depression in the USA. 160 billion dollars debt; the GDP has contracted to 70 billion dollars.

Diego Ramiro Guelar, Argentine Ambassador to the USA] [Wilson Center, October 30, 2002]

Argentine “tragedy”: the worst social and economic crisis in Argentina, even worst than “the Great Depression.”

Long agony of the negotiations with the IMF.
Attempt to overcome the crisis; participation of local and international NGOs, supporting the alleviation of the crisis.

From October 2001 to May 2003, more than 5 million middle-class Argentines fell under the poverty line. Taking the country as a whole, 53 percent of the urban population became poor, while the situation in rural areas is much worse. In a country of 36.2 million inhabitants, this means that approximately 19 million are poor. Seventy percent of children live at or below the poverty level. [Lopez-Alves 2007, 56]
A5. Back from the Brink, 2002-2007

(4) After the crisis: Kirschner: adopted a “radical” perspective: “the IMF is responsible”: default on all the loans from the IMF and private loans, playing a dangerous name [but ultimately quite successful in political terms].
|Argentina defaulted on 150 billion $

After falling 10.5% in 2002 (much of which is explained by the acceleration of the recession in the last half of 2001), by late 2003 the economy was surging ahead at around 7 percent. [Llach 2004, 47]

No longer servicing loans, the economy rebounded, and unemployment came down from an estimated high over 50 percent to a still difficult, but at least better, 17 percent. Ironically, economic globalization, never very popular in Argentina, responded to the weak peso to help put people back to work. Suddenly, exports, made inexpensive by currency devaluation, resulted in a trade surplus. A budget surplus also materialized, adding substance to the popular belief that bondholders, the IMF, and others had been parasitically draining the country. [Maclachlan 23006, 177].

By the end of 2003 the economy began to reclaim lost ground as idle factories resumed production. The GDP expanded by seven percent, while inflation held at three per cent. The economy with its debts unpaid continued to recover. [Maclachlan 2006, 178]

Kirchner's decision to concentrate on reviving domestic employment before addressing the demands of creditors slowly stabilized the economy. A high Euro exchange rate relative to the dollar and the peso and low interests rates helped lift the economy. Moreover, soybean prices in 2003-2004 continued to be strong. [Maclachlan 2006, 180]

Nevertheless, Kirschner's economic policy challenged the wisdom of traditional IMF method of imposing harsh measures to shock a country into recovery, no matter what the immediate social and economic cost. [Maclachlan 2006, 180]

The country's successful passage through default obscured the reality that Argentina had stabilized at a lower socioeconomic level than in 1998. Real wages fell 30 percent and many lived below the poverty line. The formal economy, with its social safety-net benefits, fell to its 1980 level. Meanwhile, the informal economy, including the estimated 8,000 rag pickers that recycle items from the garbage, doubled. [Maclachlan 2006, 180]

Agricultural destructive exports: oil, soja, beans, energy, natural gas.
Rise of underclass, cartoneros, shanty-towns, shrinking of the middle class, empowerment and enrichment of the elites.

We would characterize the government of Nestor Kirchner as a sort of leftist, progressive-populist government that emerged in part as a reaction to neoliberal reforms and the political fragility they provoked. [Lopez-Alves and Johnson 2007, 5].
Argentina has tried to find a way to retain the benefits of liberalism while at the same time creating a more progressive regime that could modify and correct the negative social effects of liberal reform. [Lopez-Alves and Johnson 2007, 6].

Kirchner wasted no time. Before his verbal confrontations with the IMF and private creditors over payments on a debt of more than $165 billion, he set out to gain support by conquering neglected social sectors. He met with human rights groups. He attracted progressives and intellectuals by capping rate hikes for public services privatized in the 1990s, and by discontinuing the privileges enjoyed by water and rail companies since the Menem years. [Gaudin 2006, 79].

Roberto Lavagna had presided over sustained economic growth and the most dramatic reduction of poverty and unemployment in years. [Gaudin 2006, 84].

**Post-election Argentina [2003]: Is Economic Recovery in Reach?**

(May 20, 2003)

John Williamson, “What actions should Argentina take?”

Consolidation of a more sober President, stabilizing, industrial production in April 2003 20% more than in 2002, growth is back, taking the necessary measures to keep growth. Reforming the banking system (it is liquid, but insolvent). Restructuring the public debt.

Need for tax reforms, including foreign income.

Nancy Lee, “Main economic challenges for Argentina”

Inflation low in 2003, as compared to 2002. Restrictions from the *corralito* have been lifted, no crisis. Reserves have been increasing (about 11 billion $). The US Treasury has been very active in the “short-term transition program”, with the IMF, a “calculated” risk.

Some conditionality by the IMF, less impressive performance in the “rule of law.” It took quite a long time to negotiate the IMF package: agreements with each province needed, negotiation of monetary targets.

Challenges include: (1) public debt restructuring; (2) systemic bank restructuring; (3) systemic tax reform (long-standing problem); (4) permanent fix for fiscal federalism; (5) elimination of quasi-money; (6) restoration of credit rights; (7) utility reform; (8) promotion of export-led growth, and trade liberalization.

The process of interaction between Argentines and financial institutions, not smooth. The IMF at the meeting point; World Bank, IDB are involved as well. Encouraging capital flows to developing countries: calibrating according to political performance, a very difficult issue.

The fiscal situation in Argentina was not compatible with the fixed exchange rate.

Norman Bailey, “Can Argentina Negotiate with its Debt Holders?”

Populist rhetorics, Kirschner as a neo-populist. Need to restructure about 70% of the debt. Capital flight has continued. Also, 70% of the debt will have to be “absolved” (“hair-cut”). Argentines have billions of dollars outside of Argentina.
Pia Rigorozzi, “Argentina’s Post-Crisis Reconstruction: Re-Asserting Nationalism in an Open Economy” (WISC, July 25, 2008):

Post neo-liberal model: the state becomes a major actor again. Argentina’s crisis of 2001-2002: emblematic case of catastrophe and recovery: economic and political failures, biggest default, also an emblematic case of incredible recovery, “good timing”: China, India, Venezuela helped to recover: the anti neo-liberal movement was triggered by poverty and inequality.

Before the crisis:
1998: recession; 2001: poverty increased from 38% to 57%, inflation increased to 41% in 2002: failure of political leadership and of the economic model.

The interesting question: how to regain political legitimacy and restore social peace?

Stage 1: Nationalistic rhetorics -> interventionist state: devaluation; tough negotiations with external creditors; conservative fiscal policies; sustained growth in 2003-2008, but is it sustainable over the long-term?

Heavy reliance on the President as mediating between actors, polarization. The political style is quite controversial and polemic.

New vulnerability of the Argentine economy: relying too much on agricultural products, tensions between the central government and the Argentine agricultural sector: the government does not have a coherent program of governance. There is new emphasis on human rights and social inclusion, but redistribution remains a big social and economic problem.
B. ARGENTINA AS A SPECIAL CASE?

1. The Argentine Malaise

Redistributive struggle since Peron.

Carlos Escude (2002), "Argentina, a 'Parasite State' on the Verge of Disintegration"

The paper analyses the breakdown of federal institutions, the atomization of power and the erosion of governability that ensued as a consequence of the financial crisis. Mafia-style political practices, an endemic evil in the background of Argentine politics, jumped to the forefront as a consequence of this institutional breakdown.

Cynics wonder why Argentina is a land of a chronically unfulfilled future of welfare and prosperity. Her successful insertion in the world economy towards the end of the 19th century, her natural resources per capita, the relatively high (albeit decreasing) education of her citizens, have sparked sarcastic remarks from wits ever since her decline began. [Escude 2002, 453].

The present crisis is associated with an unprecedented and financially unsustainable level of indebtedness. [Escude 2002, 453]

Argentina's overwhelming state indebtedness is the result of years of political mismanagement, fiscal irresponsibility and corruption. [Escude 2002, 454]

One may conclude that Argentina's exaggerated per capita indebtedness is the product not so much of corrupt political practices but of Argentina's unique Convertibility policy, which pegged the peso to the dollar and subjected the country's monetary policy to a straitjacket that made borrowing necessary when revenue was insufficient. According to this line of argument, Argentina's unique debt situation is the product of a unique policy among comparable countries. Yet this alternative explanation ignores the fact that this policy was the forced product of skyrocketing hyperinflation in 1989 and 1990. Thus, even before Convertibility, Argentina's hyperinflation clearly indicated uniquely corrupt and/or demagogic political practices. Convertibility did not cause eventual collapse; rather, both were the twin products of a tainted political legacy. [Escude 2002, 455].

The present economic crisis has both its start- and end-points in the erosion of the rule of law. Indeed, the main thrust of this paper will be show that political practices that seem endemic to Argentine governance are at the root of the present financial collapse, which, in turn, has engendered a crisis of the federal union betwixt the provinces and the rule of law itself/ [Escude 2002, 455].

A Financial Black Hole

Among the endemic practices that haunt Argentina are chronic fiscal deficits. [Escude 2002,455].
There was the massive violation by the state of the property rights of its citizens by impositions of withdrawal limitations on bank deposits during the Cavallo/de la Rua administration in early December 2001. [Escude 2002, 456]

It is not incorrect to state that Argentina is no longer under the rule of law. [Escude 2002, 457]

Old Vices

Argentina's current position is not the result of market failure or policy misjudgment. In fact, the political practices that have led to financial collapse and erosion of the rule of law seem endemic to Argentine governance. Severe financial crises, often due more to local mismanagement and corruption than to external shocks, can be traced far into the history of modern Argentina [Escude 2002, 457].

The Crisis of the Federal Union between the Provinces

Policy paralysis or more populism can lead to hyperinflation and widespread rebellion, whilst active policies of fiscal adjustment can also ignite social violence. Both can lead to rebellions of individual provinces against the central state. It seems clear that a tainted historical legacy that has been reinforced time and again has generated a self-destructive dynamics. As stated, in 2002, just like in 1890, one of the more serious problems is provincial overspending. [Escude 2002, 459]

The Atomization of Power and the Rise of Mafia Politics

As governance through institutions has been eroded because abuse in over-spending as made the federal compact non-viable, the power wielded in today's Argentina is increasingly territorially based. With the army deactivated and the federal institutions in crisis, real power of enforcement is not pan-Argentine but limited instead to each province's territory. Governability is fragile on a national basis but not necessarily in each individual jurisdiction. [Escude 2002, 461]

Conclusions

The man in Casa Rosada, the legislators and the Governors are all caught in a clientelist trap. Over decades, Argentine political elites have built an unsustainable state, winning election through the generation of artificial public employment leading to chronic fiscal deficits and indebtedness. [Escude 2002, 466]

Globalization could not resolve the old sources of uncertainty and added other instead; thus, since the second half of the 1990s, Argentines have experienced the highest levels of [political and social] uncertainty in recent decades. This period has been characterized by institutional and political unpredictability, alarming and unprecedented unemployment rates in comparison with the past 20 years. [Lopez-Alves 2007, 58]

During the 1990s, but especially during the second half of that decade and the early years of the twenty-first century, growing pessimism about the personal future of
citizens and about the collective future of the country overcame the optimism of the 1980s. [Lopez-Alves 2007, 61]

We can conclude that starting in the mid-1990s, the neoliberal vision of a better society, with its emphasis on individual rationality, efficiency, free-market choice, and intense engagement in global market competition, faded away in Argentina. [Lopez-Alves 2007, 71]

This is a democracy in which the public believes that democracy is better than authoritarian alternatives but also thinks that the political system does not work properly and is not to be trusted. The state is perceived as a weak actor and international factors as wielding most of the power. [Lopez-Alves 2007, 72]
2. Winners and Losers of Globalization in Argentina


Argentina is currently in the midst of a deep and unparalleled economic, social, and political crisis. After three years of continuing recession, the economic and financial crisis deepened during 2001. Various attempts were made throughout 2001 to spur growth as a prelude to improved public finances and the debt profile but to no avail. Market perceptions of risk of default increased, especially in mid-2001. Efforts to protect the banking system from widespread withdrawal of deposits (the corralito) resulted in strangling of liquidity and economic activity and generated popular discontent.

This finally culminated in the resignation of then President de la Rúa in December 2001, a quick succession of appointed Presidents, a formal announcement of default on public sector borrowings, and in early 2002, the abandonment of the Convertibility Plan.

Now in its fourth year of recession, the economy in 2002 is projected to decline by about 16%, bringing the decline in GNP to over 25% since its 1998 peak. With the peso depreciating sharply since its float and undefined monetary policy, Argentina is experiencing significant inflation for the first time since 1991. Between the decline in economic activity and the currency’s depreciation, per capita GDP has declined sharply, to a projected $2,850 in 2002 (down from $8,210 at its peak in 1998).

The downturn of the past six months has sharply aggravated the already difficult social conditions in the country. Already high levels of unemployment (18.3% in October 2001) have jumped to 21.5% as of May 2002. Moreover, the destruction of jobs (particularly unskilled jobs) has been sharp.

During the first quarter of 2002 the construction industry fell by 25% with respect to the last quarter of 2001. Poverty is also on the rise, confirming the well-known links between economic crises and sharp increase in poverty. Official estimates for 28 urban centers indicate an increase [in poverty] from 38.3% in October 2001 to 53% in May 2002. This extremely negative context has also had a strong impact on the health and education sectors where there is growing evidence of deterioration in service delivery. The combined effect of all these factors has resulted in an increasingly conflictive social situation with high levels of crime, violence, and diverse forms of protests.

_George Shambaugh, “The Case of Argentina” (Lecture at Georgetown, August 1, 2005; August 2, 2007)_

Argentina in the 1990s: different dimensions of globalization: glories and backlash of globalization.

Economic chronology, there is a particular economic-historical context to make sense:

(5) late 1980s-1990s: massive hyper-inflation; Menem and Cavalho follow liberal viewpoint of the Washington Consensus, massive privatization campaign, influx of Italian and Spanish companies, Argentina becomes globalized, the services improve substantially.

In this period, decision to peg the currency to the US$, convertibility law, inflation dropped from 2,000% to 2%; massive influx of investments, FDIs: private banks, access to loans, globalization. This was a domestic political initiative, than leads to globalization of the Argentine economy: tie to the Federal Reserve of the USA; brings FDIs: massive influx of foreign capital; privatization; unemployment.

Who are the winners? Foreign investors; consumers; the new middle class.

Who are the losers? The older generation; unemployed now (50s-60s).
3. Poverty and Inequality in Argentina

Maria del Carmen Feijo [October 30, 2002]

Structural changes in the last twenty-five years.
In 1974, 4.7% of the population were poor; in 2,002 about 50%; about twenty million, half of them undernourished.
Evolution of the inequality of income, worsening of the GINI, more unemployment.
Parallel to the growth of the GNP, more poverty!
In 1980 there was a structural type of poverty; in 2002, the “new poor”.
The crisis of December 2001: economic, governmental, social eruptions, urban intifada, survival crisis.
New social programs in 2002.
Poverty as lack of income.

Ernesto Aldo Isuani [October 30, 2002]

Increase of poverty, inequality of income: the phenomenon of “social exclusion”: masses of people that cannot generate income; lack of sense of social integration: social violence, suicide.

The social expenditures: ½ in the hands of the provinces (education and health); 2/3 of public expenditures.

Economic growth cannot resolve the social problems.


The Argentine social crisis as a symptom of a larger Latin American crisis. A process of the last twenty-years.
From 41% to 44% below the poverty line in Latin America; about 51.4% in Argentina.

The Middle class fall in Argentina: in 1960, about 53% of the whole population; in 1990-2000 seven million people (about 20% of the population), become poor (the new poor).

Evolution of social polarization, inequity and inequality, the most unequal area of the world


The country’s economy has collapsed: unemployment, poverty, hunger. 22% unemployment. Problems of providing food.
Poverty rate: from 32.6% (1998) to 51.4% (May 2002) to 58% (December 2002).
Number of impoverished: 18,219,000; 7,777,000 destituted.
The middle class fell: they were 53% in 1960; 7 million people became poor, 20% of the population. One of the worst GINI in the region.

_Leonardo Gasparini, Mariana Marchionni, Walter Sosa Escudero, “A Characterization of Inequality Changes in Argentina through Microeconomic Decompositions”_

Small change in inequality between 1986 and 1992. In contrast, between 1992 and 1998 nearly all factors played in the same direction [of increasing inequality]. The increase in the returns to education, changes in endowments for unsolvable factors and their remunerations, and the fall in hours of work by low-income people are particularly important to explain the growth in inequality in the nineties. In contrast, although Argentina witnessed dramatic changes in the gender wage gap, the unemployment rate and the educational structure, these factors appear to have had only a mild effect on the household income distribution.

From October 2001 to May 2003, more than 5 million middle-class Argentines fell under the poverty line. Taking the country as a whole, 53 percent of the urban population became poor, while the situation in rural areas is much worse. In a country of 36.2 million inhabitants, this means that approximately 19 million are poor. Seventy percent of children live at or below the poverty level. [Lopez-Alves 2007, 56]

_Democracy and Inequality in Argentina_

Argentina's pattern of inequality matches its political history – falling during democratic periods and rising under dictatorships. Inequality fell rapidly during the 1920s, rose at the end of the authoritarian 1930s, and fell dramatically under Peron's more populist administration. After his overthrow in 1955, it rose rapidly, stayed mostly unchanged during the 1960s and fell again during the second Peronist administration from 1973 to 1976. After the 1976 coup, it rose sharply, although it increased during the 1990s, the first instance of rising inequality in Argentina during democracy [but then it fell under populist Kirschner, new left] [Robinson 2003, 73]

Rising inequality in the post-military period probably stems from structural political changes induced by the military regime when they manage to demobilize trade unions and the left, to eliminate the political base for redistributive politics. [Robinson 2003, 74]
4. EXPLAINING THE GREAT CRISIS OF 2001-2002

The Argentine crisis was a result of multiple economic causes, which cannot be fully understood unless we refer to the main features of the political system and the poor quality of the institutional context in which key economic decisions were made before and during the crisis. [Chudnovsky and Lopez 2007, 139]

Explanations of the unparalleled crisis have largely focused on corruption and economic policymaking during the heady 1990s and the alleged incompetence of the hapless president Fernando de la Rua. Critics of the policy of economic liberalization pursued during the presidency of Carlos Menem argue that Argentina had become another victim of "neoliberalism", which had been actively promoted by the US government and the IMF under the "Washington Consensus." Others insist that Argentina had failed to implement neoliberal economic reform with enough determination. They argue that Menem and de la Rua had been unable or unwilling to control public spending and had been forced to borrow from abroad to continue to govern. Foreign debt combined with the fixed exchange rate of the Convertibility Program made Argentina vulnerable to the sudden reversal of financial flows. If the IMF was at fault, proponents of this view argue, it was not because they had imposed "orthodoxy" but rather because they had failed to do so consistently. [Veigel 2009, 3]

Political and Domestic Considerations

The non-economic causes of Argentina's depression point to institutional, political or even cultural elements as the critical factors behind the crisis. The institutional fragility characteristic of Menem's era, the scant capacity of Argentine politicians to manage public affairs or to reach basic agreements, or even an alleged inability of Argentine society itself to behave in a way compatible with economic growth (supposedly manifest, for example, in a feeble respect for the law or in self-indulgent levels of consumption and leisure) have all been advanced as related to Argentina's misfortunes. [Llach 2004, 47-48]

Sub-National Connections [the power of the provinces]:

The inability to introduce reforms certainly played a major role in the Argentine crisis. The "straightjacket" of the convertibility regime seriously restricted the set of potential instruments at the government's disposal. In particular, unable to resort to devaluation, the government could have only improved its finances by improving tax compliance, reforming the existing revenue sharing system, and reducing public sector payrolls at both the federal and provincial levels. However, these tasks proved impossible: first, because of the preponderant role played by provincial governors in Argentine politics; second, because, despite the country's deteriorating conditions, these key players did not have any incentive to change the status quo. Provincial governors had a guaranteed transfer regardless of the country's economic performance. By 2000, the federal government was paying very high interest rates to borrow money, in part to make monthly payments to the provinces. Only when
sovereign borrowing dried up (by mid-2001) did the federal government stop making those transfers.  [Saiegh 2004, 108-109]

The governors certainly cannot be held responsible for the crises. However, they did not have any proper incentive to "internalize" the consequences of the country's macroeconomic fate in a timely manner. The lack of proper incentives is rooted in the Argentine political system.  [Saiegh 2004, 109]

The "upper-hand" that governors have in the policy-making process makes it very costly for Argentine presidents to pass legislation that affects provincial interests.  [Saiegh 2004, 119].

As the economic situation deteriorated in 2001, and public revenues continued to fall, it became increasingly difficult for the federal government to keep the monthly transfers. The resignation of De La Rua showed the degree to which a president with little political support can unleash a dangerous spiral that further weakens his position and renders the country increasingly ungovernable.  [Saiegh 2004, 120]

Political strategy: allowing the provinces to spend; corruption, internal and historical crisis. [Teichmann]

**Richard T. Mc Comack** [October 30, 2002]:

Economic, political, constitutional, law, and order problems.

Argentines could look at Brazilians as a model .

Need for a comprehensive strategy.

What actually caused the economic disaster? [good question]: the “Washington Consensus”?

There might be elements of the Washington Consensus that have to be reviewed.

Without economic growth, democracy will not survive.

**Osvaldo Hurtado (from Ecuador, commenting on Argentina, March 20, 2003):**

Argentina is one of the best educated societies in Latin America; with a formerly strong middle class. Among its problems: populism since Peron; corruption; lack of law; weak institutions; provincial autonomies. Importance of political, cultural, institutional causes (not economic).

**Allyson Berton, “The Provincial Origins of National Economic Instability in Argentina”** (LASA Dallas, March 27, 2003]

Decentralized federalized system; provinces have lots of autonomy.

Starting in the 1930s, governments favored the “interior” (for lack of economic development): fiscal and economic policies targeting specific provinces.
In 1989 with Menem, national economic reforms affected the national bureaucracy (about 55%), but the provinces were not required to reform: the provincial governments continued to spend.

Why did the government not change the revenue sharing? The Congress posed an obstacle, undermining national economic stability.

**Explaining the Argentine debacle (interview with Carlos Escude, 17 September 2004)**

1. erosion of government power: erosion of the authority of the state;
2. a political system of patronage
   In the Argentine case, the crisis is mainly endogenous.
   There was not a complete implementation of the neo-liberal model;
3. misperceptions regarding the so-called “Argentine economic success”; biased.
4. Deliberate manipulation: Argentina was considered a safe investment,
   manipulation.
In the second half of the 1990s, already poverty, unemployment, lack of growth;
5. capital flights.

**(Interview with Federico Merke, 20 September 2004)**

Crisis of 2001, exacerbation of the social inequality.
The growth in the 1990s, without development.
There was not a complete implementation of the Washington Consensus, the fiscal deficit was not balanced; the problem was not the blueprint but the bad implementation.

Argentina: there is a private sector + modern society+ weak state, withdrawal of the state: privatization without accountability; more corruption (a political culture factor).

By contrast Chile managed to keep the state and to modernize the public functions.

The main [Argentine] problem is internal, not external.

**Cultural Explanations** [Aguinis, Grondona, Ulanovsky]:

Argentines are described as, among other things, corrupt, immoral, cynical, mistrustful, unscrupulous, anti-social, authoritarian and arrogant.

This kind of approach to the crisis is categorical when it comes to identifying those responsible for the crisis, those "guilty" of producing this situation: the Argentines themselves. The crisis is interpreted as one more step in a history of failures.

[Foirucci 2004, 156]
**Economic Considerations (International Considerations)**

**Jan Peter Wogart, “Misery Revisited: Old and New Lessons from the Argentine Crisis”**

External forces sweeping the globe, globalization, having an impact on the Argentine economic crisis.

The convertibility plan in action:

Concepts: peg exchange rate; open capital markets; constrain fiscal policy; reduce protection; strengthen the financial system.

Expected results: reduce inflation; attract capital; stimulate production investment; expand GDP; capacity to serve debt.

Actual Results:
In 1991-1998: inflation banished; growth resumed; fiscal restrain; finances strengthened; debt enlarged.

In 1999-2002: From inflation to deflation and recession; growing fiscal gap; unsustainable debt service burden; losing trust one more time.

Major actors in the drama:
In Argentina: policy makers; politicians; interest groups; investing public; resourceful people.

In the world: the multilaterals; the banks; the landholders; US; EU; Mercosur.

To what extent was the model bound to crash?

Once the IMF decided not to bail out Argentina: the markets panicked; unlike in the “Tequila crisis” of 1994-1995 in Mexico.

Argentina’s external debt raised from 61.3 billion dollars to 146.1 billion dollars (from 23.1 % of the GDP to 51.6% of the GDP).

Argentine vulnerabilities -> fiscal account and competitiveness -> external shocks -? Crisis.

The Argentine case is unlike that of Mexico and Brazil, in that it is not a crisis that can be overcome within a relatively short time. It has similarities with the Brazilian case, however, in that the fallout from external events (the Asian and Russian collapses for Brazil and the Brazilian devaluation in the Argentine case) was a precipitating cause of what followed. [Weintraub 2003, 119].

The systemic aspects of the Argentine case are an extension of the country’s own structure. Argentina, even more than Mexico and Brazil, was highly dependent on capital inflows. When these slowed down, ceased, or became inordinately expensive
because of internal political and economic events, serious economic problems were created. [Weintraub 2003, 120]

*Neo-liberalism as an explanation [flawed!]*

The widespread notion that Argentina's crisis was a consequence of the enthusiastic application of "neo-liberalism" (the Washington Consensus) is problematic. The eight-year lag between the onset of the reforms and the recession itself is hard to account for. Also, although deregulation, privatization and trade openness arguably all have both advantages and disadvantages, there are no good reasons why any of them should lead to a recession. [Llach 2004, 48]

*External shocks (flawed?)*

A purely external explanation of Argentina's rise and fall during the 1990s is more satisfactory, at least in relation to timing. Capital flows to emerging markets during that decade show a high correlation with the evolution of the Argentine economy. [Llach 2004, 49]

A second type of external shock acted on the commercial rather than on the financial side of Argentina's balance of payments. Specifically, the combination of the devaluation of the Brazilian real, the renewed strength of the super-dollar and a deterioration in Argentina's terms of trade (all in 1999) endangered external sustainability. While those shocks would normally imply a recession, and even if they may be jointly seen as a necessary precondition for the crisis, a recession of 20 percent with unemployment reaching 25 percent looks like an abnormal reaction to those external shocks. [Llach 2004, 49-50]

During 1998-1999, the Argentine economy suffered a series of external shocks as a result of the Asian, Russian, and Brazilian crises. These shocks, combined with the weaknesses of the Argentine economy, led to a long recessive period that ended in the biggest crisis in the country's history in 2001-2002. [Chudnovsky and Lopez 2007, 135]

The external shocks were different in their features and repercussions from those that resulted from the 1995 crisis. While the capital outflow was a financial disturbance on both occasions, only in the latest crisis were the real shocks negative. In this connection, the devaluation of the Brazilian real, the appreciation of the US dollar, and the fall in export prices and the terms of trade, resulted in a dramatic fall in the export sector's profitability and, therefore, affected its capacity to obtain foreign currency. [Chudnovsky and Lopez 2007, 141]

The Argentine economy showed important weaknesses that made the absorption of the external shocks difficult. First, in the context of Convertibility, there were few available adjustment mechanisms to deal with the increasing appreciation of the real
exchange rate. Second, the public sector had a poor fiscal discipline. Third, there were restrictions on economic policy decisions that mainly came from the disenchantment of wide sectors of the civil society as a consequence of the evolution of unemployment, income distribution, and poverty during the 1990s. [Chudnovsky and Lopez 2007, 142]

Paul Blustein (2003), "Argentina Didn't Fall on Its Own: Wall Street Pushed Debt Till the Last"

The Argentine government defaulted on most of its $141 billion debt and devalued the nation's currency. A wrenching recession left well over a fifth of the labor force jobless and threw millions into poverty.

Other factors besides optimistic analyses impelled foreigners to pour funds into Argentina with such reckless abandon as to make the eventual crash more likely and more devastating. This behavior was a major contributor to the downfall of a country that prided itself on following free-market tenets. The optimism emanating from Wall Street, combined with the heavy inflow of money, made the Argentine government comfortable issuing more and more bonds.

The same forces that fueled the U.S. tech-stock frenzy were at work in Argentina, in effect causing economic globalization to play a cruel trick on the country.

Particularly important was Argentina's determination to maintain its currency "convertibility" system, which guaranteed that the central bank would exchange pesos for dollars at fixed rate – one peso for one dollar. Implemented in 1991, that system was remarkably effective in keeping inflation at bay, imparting a sense of stability among consumers, savers and businesses that had been absent for generations.

The government had to shrink its budget deficit, because its constant borrowing was causing its debt load to increase, from 29 percent of gross domestic product in 1993 to 41 percent of GDP in 1998.

Argentina's best chance to put its economy on a sound footing was gone soon thereafter, as supercharged growth gave way to recession in 1999, mostly because of a financial crisis in neighboring Brazil. At that point, a vicious circle emerged: The slump caused tax revenues to fall, which widened the budget deficit, which aroused concern about the government's ability to service its debt, which caused markets to drop, which deepened the recession, and so on.

Contagion Effect of Financial Crises

Each of these financial-economic crises had distinct precipitating events. The causes were rooted in the international financial system itself, in the contagion that was evident between a Russian default and a Brazilian crisis, and in economic policies of each of the countries. There were political antecedents based on each country’s history, practices, and habits of government. [Weintraub 2003, 109]
**Intermestic and Political Economic Considerations/Causes of the crisis/ Economic Causes (Internal)**

*Convertibility as an explanation for the crisis*

Argentina's monetary system is another possible culprit. While the pegging of the *peso* to the dollar proved to be an extremely powerful hyperinflation killer, it brought problems of its own after stabilization. According to what may be called the "monetary hypothesis" of Argentina's depression of the millennium, convertibility presented problems for both the real and the financial side of the economy. [Llach 2004, 50]

After 1998 external prices measured in dollars began to fall, and foreign funds initiated their flight to quality. Argentine import-competing industries, which had managed to survive the opening up of the economy during the previous years, suffered heavily from the combination of external shocks and fixed nominal exchange. [Llach 2004, 51]

*Fiscal Policy*

Another explanation of Argentina's crisis is the fiscal hypothesis. According to this view, public deficits higher than those sustainable in the long run were the main cause of the depression: Argentina's recent crisis was just another episode in the country's enduring flirtation with populism. [Llach 2004, 52] Yet, during the whole period 1991-2000, the budget deficit of the central government averaged 1 per cent of GDP. Hence, budgetary weakness was provoked by the convertibility regime. [Llach 2004, 52]

*False Expectations*

Everybody seemed to expect that Argentina was able to sustain its level of dollar income typical of the mid-1990s, around or over $8,000 per capita. The reforms of the early nineties presumably raised expectations as to the future productivity of the Argentine economy. Those expectations increased the perceived wealth of both public and private agents, thus inducing an expansion of public and private consumption. Starting in 1998-1999, however, those expectations faltered as bad news came from abroad. [Llach 2004, 54-55]

*What Then?*

What happened in Argentina was quite extraordinary: after being one of the fastest growing countries in the world in 1990-1998, it experienced an unprecedented depression. Many emerging markets opened up to foreign trade and finance during the 1990s. They were all subject to capital flows and trade shocks. A majority of governments around the world normally run a fiscal deficit, and most of them have higher public debt to GDP than Argentina had before the shocks of the late 1990s. Yet, only Argentina combined all those elements with the convertibility system, and that made Argentina different. Argentina was more vulnerable to capital flows because in times of great expectations it looked like the 51st US state in a strict
monetary sense; but in hard times the suspicion of a sizeable devaluation entailing a banking crisis and a potential default would scare capital away. Trade shocks (that is, international deflation and deterioration in terms of trade) affected Argentina more than other countries because the downward adjustment of the exchange rate necessary to accommodate those impacts from abroad could only be effected through a costly deflation. Argentina's government could have saved in prosperous times so as to avoid future financial difficulties, especially those arising from any devaluation. Intense demands on the budget, not least those coming from the provinces, were not conducive to that type of precautionary behavior. But the appreciation of the peso made fiscal matters worse, as it pushed public spending upwards and prompted tax reductions and exemptions to deal with the competitiveness issue. As for false expectations, they were certainly amplified by the strong currency. People and politicians assumed that their dollar incomes were sustainable not only because they were optimistic about the future course of the Argentine economy, but also because they thought that nominal adjustments downward would be limited, and thus dollar-incomes would never implode as long as the convertibility system remained in place. [Llach 2004, 56]

A perverse political economy logic guaranteed that Argentina would not voluntarily give up its new monetary system. [Llach 2004, 57]

There were also deeper reasons for the general complacency about convertibility among both Argentine citizens and their political leaders. Argentina had traditionally been a quite egalitarian society. For some time, convertibility prevented an even steeper decline in the direction of inequality. If it was really the case that Argentina's currency appreciated during most of the 1990s, it means that wages were higher than those justified by productivity considerations. Ultimately, those higher-than-equilibrium wages showed up in increasing unemployment [Llach 2004, 58]

**Domingo Cavalho:** “Argentina 2002: When the Attept to Set the “Right Prices” Destroyed Property Rights” (Georgetown University, lecture on November 25, 2002)

2002: attempt to set the “right prices” (the dollar being overvalued), the government destroyed “property rights” (which is even worst).

The convertibility law included two propositions:

1. pegging of the peso to the dollar;
2. legalization of the use of foreign currencies in local contracts in dollars.

Between 1991 and 1998 the convertibility law stabilized the Argentine economy; and spurred a significant increase in investment; laid the ground for the opening of trade and investment deregulation and privatization, all of which contributed to increased productivity.

Significant increase in investment: 47 billion dollars annually in the 1990s; impressive expansion of GDP and export growth, 4.6% per year in the GDP; Argentina outperformed Brazil, it grew 7.9% per year.

The current recession started in mid-1998 and was caused by:
(2) Crowding out of bank credit due to excessive spending and borrowing by the provinces in 1997 and 1998; The convertibility of the 1990s did not resolve the economic problems of Argentina, since there is a lack of legalist culture, and of stability.

The convertibility of the 1990s did not resolve the economic problems of Argentina, since there is a lack of legalist culture, and of stability.

(3) Competition between Menem and Duhalde (Buenos Aires): Duhalde borrowed from the BPBA; Menem financed other governors; the debt of the provinces increased significantly: wrong decision on the side of the provinces, facilitated by the federal government; and also wrong decision by the banks.

(4) The Asian, Russian, and Brazilian crises provoked an outflow of capital from emerging markets, restricting credit to the private sector.

(5) Currency appreciation of the peso, due to the devaluation of the Brazilian Real and depreciation of the Euro after January 1999, adding deflationary pressures to the recession, leading to depression.

This recession could have been avoided either by starting the flotation of the peso back in 1997, at a time of large capital inflows; or changing the peg to the Dollar-Euro in January 1999, there was more trade with Europe than with the USA, it could have been the best idea if Brazil could have adopted a similar policy.

Why did the politicians did not implement those options? It would have required early reversal of the excessive borrowing by the provinces; the politicians focused on the elections of October 1999.

Still, growth could have been regained in 2002 by:
(a) continuing the use of taxes and deregulation to readjust relative prices;
(b) Argentina should have reduced government spending through debt restructuring in order to eliminate the fiscal deficit. “Zero deficit” was an economic necessity, in order to keep borrowing.
© Floating the peso within limits (dollar and Euro)

The new government in January 2002 decided:
To freeze deposits in the banks, banning the use of savings for payments through bank transfers;
To transform dollars into pesos at a below-market rate and to start floating the peso without eliminating exchange control, leading to a huge devaluation of the peso.
The termination of the convertibility law lead to the demolition of the institutional base of the Argentine economy.

complete dollarization and expenditure cuts;
Other proposed formal default and abandoning the peg.

Eventually, the measures adopted to attempt to set the “right prices” destroyed “property rights.”
Without convertibility, in the sense of legal enforcement of contracts in foreign currencies, there will be neither investment, nor productivity growth.

What needs to be done?
- The Supreme Court reinstates the Rule of Law by unfreezing deposits and revoking pesification;
- A new elected government will provide a credible commitment to recreate the conditions for investment and productivity growth.
- Widespread corruption, inefficiency, and political favoritism have to be eradicated from social policies.

Need for better domestic policies; need for good governance, need to improve decision-making.

Pamela Starr, “The Political Economy Origins of the Argentine Crisis”

A restrictive monetary problem badly implemented, plus bad luck, less to do with the IMF [and with globalization].

The “currency board”: in the short term a stunning success, but it caused unemployment: inflow of capital, foreign reserves but there is “no free lunch”: (1) over-valuation of the peso; (2) Mexican crisis, recession, less spending, recession in 1995-1996; (3) the consequences are difficult to sustain politically in the long term, the political structure is poorly suited; (4) the Argentine companies are not competitive, not only because of over-valuation: monopolies in the service sector; pegging to the dollar, who rose.

The Mercosur market somehow helped Argentina along, there was some protection; dependence on the Brazilian economy.

There was a serious problem of fiscal reform: 1.2 billion dollars per month going to the provinces; the provincial governors had a tremendous political leverage, hence, fiscal reform is enormously difficult in political terms.

Labor reform was also needed; it retained power within the Peronist party: Since 1996 Duhalde supported the unions against Menem: Argentina could not resolve its competitive problems.

Argentina also increased its debt to 50% of its GDP: vulnerability in the international financial and capital market.

Argentina was also affected by the 1997 Southeast Asian crisis.

Also, indirect impact through the Russian crisis, instability of financial markets; then, Brazil’s crisis in 1999: devaluation of the “real”: Brazil’s crisis affected the Argentine economy; FDIs moved from Argentina to Brazil; brought about recession and economic crisis.
At this point, Argentina had to cut its fiscal spending, but it did not.

April 1999: pressure of the IF to cut government spending, but Congress posed an obstacle: President De la Rua encountered a difficult fiscal situation; he had to refinance the debt service, bringing about budget austerity; then labor reform in May 2000, but the actions were insufficient: the markets did not trust De la Rua; De la Rua stambled; chaos.

In November 2001 the IMF decided not to grant another loan, run of the banks, the “corrallito”, the crisis.

Lessons to be drawn:
- Financial markets cannot discipline national governments;
- The IMF can help national policies to discipline;
- Poor fiscal/economic management is directly related to Argentine politics; do not blame IMF and globalization for that;
- Fiscal federalism can go horribly wrong.

Alternative explanations for the failures:
- the model of neo-Liberalism itself;
- the implementation (failed in the small details)
- a comedy of errors: bad luck.

The problem of the late 1990s (unlike 1995) was the adverse consequences of external variables, and the changes in the external environment.

*Interview with Juan Carlos Torre* [September 21, 2004]


How does Argentina react? There is a delay: in 1996 or 1997 Argentina had to opt out [from the Convertibility Plan], but there is inertia. Why? Sociological or political explanation: there are vested interests on the part of the government and even foreign investors. The convertibility policy is still very popular (70%), especially with the middle class.

In 2001 the crisis explodes, there is a capital flight, the government remains naked, vulnerable.

*The Argentine Economic Crisis* [Sebastian, May 25, 2005]

Until 1999: 10,000$ GNP per capita; more than 50% were part of the middle class; high level of social education. The debt grew to 160 billion $.
In 2002, 51.4% of the population below the poverty line; 22% unemployed, social polarization and violence, even starvation.

Arguments and factors that explain the economic crisis:

(2) **Implementing the Washington Consensus**: Adoption of liberal policies, dropping ISI, the middle class got the worst part, Argentina liberalized its economy and opened its borders.

(3) The work of the *financial markets*: Speculation, encouraging of speculation.

(4) **Domino effect of globalization crises in the late 1990s**: Russia, Mexico, Brazil, and then Argentina.

(5) **Political and institutional (domestic) factors**: The difficult relations between the central government and the provinces. Menem and Duhalde (PJ Buenos Aires), clientelism: the provinces had a lot of autonomy, continued with clientelism.

(6) **Inertia**: The flowing of capital continued into the late 1990s, but the money was not invested. Recession started in 1997, but Argentina still maintained the artificial parity.

(7) **Corruption**;

(8) The *debt* represented 250% of the GNP

(9) Devastating effects, vicious circle: no tax collection -> imbalanced budget -> no ability to pay back the debt.

In a way, domestic factors exacerbated the external impact and shocks.
LINKS BETWEEN GLOBALIZATION AND POVERTY: AN ARGENTINE IMPLEMENTATION

*Poverty and Globalization in Argentina*

What is the relationship between neo-liberalism (Washington Consensus), and the increase of poverty in Argentina since the 1990s?

Total poverty: about 57.5%; the “new poor”: 35% (25-30% middle class), collapse of the social system in Argentina.

Other causes of poverty: (1) political culture; (2) the federal/institutional system; (3) corruption.

Why the Argentine social system collapsed?
Blaming the IMF and globalization as a convenient scapegoat.

1. The Liberal Argument
2. The Radical Argument

*The anti-imperialist explanation* [Rapaport]:

Capitalism and liberalism as the main culprits [globalization], anti-imperialist explanation. With an intricate and obscure combination of anti-liberalism, *nacionalismo*, anti-globalization discourse, dependency theory and Argentine historic revisionism, authors link the causes of Argentina's poverty to the global capitalist system. The recent crisis is seen as the result of the actions taken by global economic powers, who, assisted by the national economic and political elites, have drained all the country's resources. The nation's economic problems were provoked by its reliance on the developed economies, which siphoned off its entire surplus under the guise of multinational corporations and financial capital. There is, as such, no profit left for reinvestment and development. [Fiorucci 2004, 159]

The main instrument used by "colonial powers" to perpetuate this dependency is international debt, which in turn is seen as the factor that triggered the last crisis. Debt – present in Argentina since independence – is portrayed as perennial in the country. As debts lead to ever more debts, because money is needed to pay interest rates, the dependency increases. [Fiorucci 2004, 160]

The liberal policies in vogue during the 1990s – privatization, a free market, and free movement of capital – are also presented in relation to speculation and indebtedness. Instead of provoking growth and the decrease of state expenditure, the outcome of these policies was more debt and recession. The opening of the markets fatally undermined an already weak industrial sector. Furthermore, the process also permitted a massive draining of financial capital that accelerated in the late nineties and during the government of De la Rua. [Fiorucci 2004, 160-161]

The guilty in this debacle can therefore be named: the imperial governments, the institutions of the world economy and the country's elite. [Fiorucci 2004, 161]

Following the arguments above, the political elite is as guilty as the economic one because it facilitated the process of "selling out" the country and served the interests of local and international economic groups, while it illicitly enriched itself. [Fiorucci 2004, 162]
3. The Agnostic/Realist Argument

Argentina is one (rather extreme) example of the point that policy-making capabilities and the quality of policies differ substantially from one country to another. [Spiller and Tommasi 2007, 1-2]

Credibility and many other desirable policy qualities depend on a policy's political microfoundations -- that is, on the extent to which political institutions facilitate the political agreements necessary to sustain effective public policy. [Spiller and Tommasi 2007, 2]

The workings of political institutions in Argentina led to shortsighted policy making, and this, in turn, to low-quality policies. [Spiller and Tommasi 2007, 3]
The Political Dimensions of the Link between Globalization and Poverty

1. Applying the model to the Argentine case

Argentina's policies have shifted dramatically over time, its inability to produce consistent public policies is the reason behind its economic misfortunes. The deficiencies of Argentine public policies are the outcome of a policy-making process in which key actors have little incentive to cooperate with one another over time, leading to myopic political and policy choices. [Spiller and Tommasi 2007, 208]

Argentina has a national policy-making environment dominated by executives who tend to have too much leeway to pursue whatever policies they fancy, provided they can buy the support of quasi-feudal provincial governors with fiscal largesse. The Argentine president often seeks the support of provincial governors for his national policies, and provincial governors' main objective is to increase the amount of federal funds they obtain to finance provincial public sector activities as well as their political machineries. [Spiller and Tommasi 2007, 208]

Interview with Marcelo Cavarozzi, September 24, 2009

Argentina is an exaggerated case, but not necessarily more unique than other cases in Latin America. Every country proclaims its exceptionality.

Argentina lacks a capable political class, like Brazil [or Chile]. At the same time, Argentina as a dynamic society: more federalization and decentralization, not a well-functioning federal system. There is only one viable political party (PJ), fractionalized. Crazy economic opening, privatization with corruption.

Interview with Jose Paradiso, September 28, 2004

Long-term crisis in the Argentine case. Argentine mentality? Fracasomania. Alfonsin led to democracy and hyper-inflation; Menem to the convertibility plan: tolerance of a neo-liberal model.
Analogy to the insertion of Argentina into the globalization by the end of the 19th century: free exchange, economic liberalism, limited role of the state.

The important remaining question: how to create intermediate institutions between state and society?

Carlos Waisman, [Political analysis of Argentina and Brazil], January 8, 2009:

Argentina [ and Brazil]: separation of powers is less clear than in social democratic regimes; a very peculiar relationship to their societies: the state relates to the mobilized poles of society (civil society): trade unions, farmers, capitalists, there is some form of civic articulation like in republican democracies. At the same time, the state also relates to the excluded: non-civic forms of articulation: ignoring them (de-politicize them), clientelism, dependent participation, corporatism: urban poor, piqueteros.
Those are partial democracies: a large contingent of the population: autonomous; another large contingent is more passive. How to incorporate the urban poor?

2. Who are the relevant political actors? An intermestic array of characters

The shortcomings of the Argentine policy-making process can be summarized as follows:
1. Congress is not an important policy-making arena.
2. The executive tends to have substantial leeway to take unilateral policy action.
3. Provincial political powers (especially provincial governors) are very important in national policy making.
4. There is a symbiotic interaction between national and provincial policy making that operates through political and federal fiscal channels.
5. Given the incentives of the executive of the day, of legislators, and of provincial governors, there is little investment in policy-making capacities in several spheres.
6. Fiscal federalism considerations are a factor in almost every policy issue, adding transaction difficulties and rigidities to policy making.
7. The bureaucracy is not an effective corps to which to delegate the technical implementation of policy bargains.
8. The judiciary does not provide much intertemporal "glue" to political or policy agreements.
9. Nongovernmental actors in the policy process (such as business groups and unions), lacking a well-institutionalized environment for political exchange, usually follow strategies that attempt to maximize short-term benefits and to build in rigidities into future policies. [Spiller and Tommasi 2007, 7]

In such a scenario, interest groups such as business and unions will also tend to follow non-cooperative short-term strategies, trying to maximize short-term payoffs whenever they have access to state resources. [Spiller and Tommasi 2007, 8]
D.3. The (missed) role of the state

Juan Gabriel Tokatlian [Wilson Center, Seminar on Argentina-US relations, March 5, 2003]

The Menem/De la Rua/ Duhalde foreign policy has been flawed because it was based on false premises: mixture of naïve neo-liberalism and utilitarianism. Opening of the market and dismantling of the state: the state cannot assert itself in world politics by dismantling itself.

Globalization could not resolve the old sources of uncertainty and added other instead; thus, since the second half of the 1990s, Argentines have experienced the highest levels of [political and social] uncertainty in recent decades. This period has been characterized by institutional and political unpredictability, alarming and unprecedented unemployment rates in comparison with the past 20 years. [Lopez-Alves 2007, 58]

During the 1990s, but especially during the second half of that decade and the early years of the twenty-first century, growing pessimism about the personal future of citizens and about the collective future of the country overcame the optimism of the 1980s. [Lopez-Alves 2007, 61]

Argentines have good reasons to feel alienated from the state and to distrust the political elite. Until early 2003, the government spent $20 billion per year on a political class totaling 9,242 members. This excluded the executive but included senators, representatives, provincial governors, and vice governors. This made the Argentine political elite one of the most expensive on the continent. [Lopez-Alves 2007, 63]

This is a democracy in which the public believes that democracy is better than authoritarian alternatives but also thinks that the political system does not work properly and is not to be trusted. The state is perceived as a weak actor and international factors as wielding most of the power. [Lopez-Alves 2007, 72]

The Argentine experience suggests that without institutional building and macroeconomic stability, even the best designed public policy is probably doomed to failure, since policymaking is a learning process that requires continuity in order to lead to positive outcomes. Argentina has much to improve in this area, as the institutional foundations of the policymaking process are still very weak and public policies largely lack credibility, stability, and coherence and are often poorly implemented. State capabilities also need to be dramatically enhanced. State restructuring is then a top priority in the economic development agenda of Argentina. [Chudnovsky and Lopez 2007, 177]
CONCLUSIONS

The Argentine recovery since: because of the international context. There is poverty now, because of inflation.

Globalization creates opportunities and risks. The key is how to manage it: Brasil vs. Argentina. [Cavalho, 2008]

The “American dream” has become a Latin American nightmare. Social standards were downgraded: democracy at risk, expectations were frustrated, living standards downgraded. Explanations such as corruption or lack of rule of law are not enough. Need for a new “social contract” in the region: political will, mutual tolerance, there is not a unique (single) mode of capitalism. Poverty remains the main problem in the region. [Rodolfo Gil in conference Georgetown, December 12, 2002].

What lessons can be learned from the Argentine experience? First, a fixed exchange-rate system, even one based on a currency board or other "hard" fix, is a bad idea that is likely to lead to an over-valued exchange rate, a currency crisis, and widespread defaults. A market-determined floating exchange rate is the only way to avoid these problems. [Feldstein 2002, 14]

Second, substantial foreign borrowing in dollars is a very risky strategy.

Third, the opening of the economy to trade, the encouragement of foreign direct investment, and the privatizing of state-owned firms are desirable policies. Those policies did not cause or contribute to Argentina's crisis, and it would be a serious mistake to reverse them now in Argentina or any other emerging market. [Feldstein 2002, 14]

In sum, pegging the currency was a domestic political choice, not because of globalization.

Globalization creates incentives and opportunities, the context, but just about that.

Globalization creates winners and losers.

Poverty has peaked after the crisis, but things have improved since.

Poverty and globalization are two aspects of the global economy, but not necessarily causally linked.

The conclusion is that international systemic realities played a role in the Argentine financial crisis, but the policies put in place at home were the overwhelming cause of the hardship suffered. [Weintraub 2003, 121]

The last Argentine crisis inscribes itself within a series of similar episodes that have been, in fact, frequent during the past decade. In this frame, even though the Argentine case tends to sand out given the unusual magnitude of the collapse, it can be considered as another milestone in the series of crisis that have been affecting the emerging markets in the globalization scenario. [Chudnovsky and Lopez 2007, 157]
Nevertheless, there are some key factors that are worth pointing out in order to understand the specificities of the Argentine case. First, a crucial element to be considered is that the Convertibility scheme was much more than a fixed exchange rate system. Second, the degree of dollarization of the Argentine economy was unusually high. [Chudnovsky and Lopez 2007, 157-158]