3. Argentina: blinded by hindsight – the economics and politics of learning

‘The rules!’ shouted Ralph. ‘You’re breaking the rules!’ ‘Who cares?’ Ralph summoned his wits. ‘Because the rules are the only thing we’ve got!’

William Golding (1954, p. 83)

I. FROM SCYLLA TO CHARYSIDES

A perennial quest and vexing dilemma of humanity has been the choice between rules, on the one hand, and discretion, on the other. Should choices be framed on rigid mandates or under discretionary flexibility? Since the myth of Ulysses this pendulum has defined the extremes within which different social, political and individual choices have been pondered and made. At the beginning of 1991, and certainly not in an act of improvisation, Argentina chose the rule of a convertibility exchange rate arrangement as the anchor for its macroeconomic and fiscal policy. By doing so it was expressing its resignation to its capacity to judiciously exercise discretion and flexibility in the management of its fiscal and public expenditure policies. For decades it had been plagued by bouts of populism and inflation. Finally it came to the conclusion that to terminate this self-imposed destiny it had to adopt a convertibility rule. Success came almost instantly. Inflation dropped from the thousands to low hundreds in 1991 and growth rebounded to 10.5 per cent. In 1992 inflation fell further to 24.9 per cent and growth remained very strong at 9.6 per cent. The convertibility regime was broadly seen as a major success. However, in that same year, in a clairvoyant article, Anna J. Schwartz wrote that ‘the sustainability of the fixed exchange rate with the dollar was still to be tested’ (1993, p. 179).

Over the following years up to 1999 Argentina lived ‘the best and the worst of times’. With the exception of 1995, when growth was negative (−2.8 per cent), and resulted largely from a Mexican contagion-induced recession, its economy expanded robustly. In 1997 it grew by 8.1 per cent. But beginning in 1999 growth was negative by −3.4 per cent, followed by
−0.8 per cent in 2000, −4.4 per cent in 2001 and −10.9 per cent in 2002. From 1999 to the end of 2002 the poverty rate rose from 30 per cent to 58 per cent. The extreme poverty rate almost tripled, going from 10 per cent to 28 per cent.

In brief, in a short period of about eight years Argentina seemed to have overcome its traditionally fiscal and monetary weaknesses and graduated to a more orthodox and prudent macroeconomic management. But the initial triumph over history did not last. Policy corrections did not come on time and from 1998 onwards the country descended into economic meltdown and political collapse. The net balance was an immense welfare loss. This economic and political debacle seems to be yet another example of the enormous difficulty that Argentina has had over many decades to manage its fiscal, monetary and financial affairs well. Why and how did this happen? What explains developments that now appear to have been predictable? What did Anna Schwartz know that led her to express reservations on the convertibility regime eight years before it collapsed? The broad answer that needs to be unbundled is why this unintended example of economic and political failure took place under such an extreme version of a collective action problem?

But are these the really ultimately relevant questions? After all, what rules were broken? Was breaking the fiscal rules the main policy flaw? If so, what explains that the fiscal rules were broken? The ‘fiscal explanation’ of the Argentina macroeconomic crisis has been well documented (Galiani et al., 2002, p. 1; Kenen, 2005, p. 51; IMF, 2004a). One of the most insightful ones came even before the crisis. In 1997 Talvi (1997, p. 73), in an example of foresight, warned of the precariousness of an initial strong fiscal position as an anchor for a stabilization program. But from a political economic perspective what explains these explanations?

This country narrative suggests as a possible complementary explicatory hypothesis that what tipped the balance of developments in the wrong direction was breaking the larger political rules and accommodating a Constitutional change for the re-election of the incumbent President in 1993. This ‘breaking of the rules within the game’ may well be the missing critical explicatory variable of developments since the mid 1990s, leading to the 2000–2001 debacle. The hypothesis is that the pervasive re-election climate during the decade changed the overall public sector incentive structure and decision making processes in favor of high expenditures, and induced an intended and unintended proclivity to take policy risks that gradually drained the macroeconomic framework of much-needed flexibility. This re-election incentive climate continued into 1998, surfaced again in 2003, and may even last into 2007 when the current President Kirchner may decide to seek re-election.
II. THE POLITICAL DEMAND FOR THE CONVERTIBILITY RULE

Within a conceptual context in which the effectiveness of a macroeconomic framework is mainly determined by the strength of the political demand for macroeconomic stability, the choice of a convertibility rule would imply the assumption that there was such political demand. But if the assumption was correct, why have the rule? You would not need the rule because the political process would already have engendered the policies that deliver macroeconomic stability. The tentative conclusion that emerges is then that there was something missing and that there was either not sufficient real demand for macroeconomic stability or insufficient political support for fiscal policies to anchor convertibility.

There might have been a dislike of hyperinflation and initial political support for the promise of its taming. But the first explicatory hypothesis is that *ab initio* there was a nominal repudiation of high inflation but insufficient political support for the policies that would contribute to macroeconomic stability. Such weak political support may originate in a nineteenth century ‘constitutional design problem’ (della Paolera and Gallo, 2003, p. 372). President Menem and Minister Cavallo, in supporting the convertibility rule, probably knew all this. Their strategy may have been to establish the rule and hope that if it delivered lower inflation the public would gradually come to support the other ancillary policies and Argentina would reach a completely different and positive development trajectory.

The literature on Argentina’s crisis experience in 2000–02 is enormous. This country narrative will focus on the following three interdependent questions in the hope of making a contribution to the learning process from this tragic experience:

i. What was the macroeconomic background\(^\text{13}\) that may explain the early political acceptance and economic success of the convertibility system?

ii. What political economy factors changed in the 1990s which may have led to the ‘wrong’ incentives in the macroeconomic governance structure and to a collective action problem in the decision making process and in crisis management?\(^\text{14}\)

iii. What are the main features of the current (mid-2007) emerging macroeconomic policy framework?

The first question aims at linking the pre-convertibility economic and political economy conditions, on the one hand, with the strength of the recovery in 2002 and 2003, on the other. In principle, the fast GDP rebound should not be surprising. The initial success in 2003 may have had more to
do with the possibility that the economy had reached bottom, after three years of contraction, than with the attributes of the convertibility arrangement. The importance of this issue is that the authorities at the time would have been more aware of the need to support the convertibility arrangement with fiscal measures. Neither convertibility nor fiscal constraint would be the main explanation for the initial success. It may well have been, in no small share, the ‘free ride’ of recovery (see Table 3.1). The importance of the second question is that it points out that what matters the most in any evaluation is not so much what was missing or what did not come about, but ‘why’ these developments occurred. This is the path towards ‘causality construction’ and effective learning. The third question is the key one. It aims at putting the whole experience in perspective in the sense that it tries to establish how much has been learnt and what political economy restrictions may still be impeding the adoption of corrective pending macroeconomic reforms. Argentina’s case contains a rich potential of lessons on the reasons why developing countries do not end up with the ‘right’ reforms.

### III. EVALUABLE HISTORY AND THE POLITICAL ECONOMY OF LESSON TAKING

In principle, the awareness of the high welfare costs of the crisis experienced by Argentina in 2001 and 2002 should inform the public at large and engender a political demand for reform of the macroeconomic governance structure. That demand would provide the political incentives to support the fiscal and attendant reforms needed. Also, in principle, since the poverty

---

**Table 3.1 Argentina: GDP growth, 1980–2006 (variation rate, %)**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Year</th>
<th>GDP</th>
<th>Year</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>1.5</td>
<td>1989</td>
<td>−6.9</td>
<td>1998</td>
<td>3.9</td>
</tr>
<tr>
<td>1981</td>
<td>−5.4</td>
<td>1990</td>
<td>−1.8</td>
<td>1999</td>
<td>−3.4</td>
</tr>
<tr>
<td>1982</td>
<td>−3.2</td>
<td>1991</td>
<td>10.6</td>
<td>2000</td>
<td>−0.8</td>
</tr>
<tr>
<td>1983</td>
<td>4.1</td>
<td>1992</td>
<td>9.6</td>
<td>2001</td>
<td>−4.4</td>
</tr>
<tr>
<td>1984</td>
<td>2.0</td>
<td>1993</td>
<td>5.7</td>
<td>2002</td>
<td>−10.9</td>
</tr>
<tr>
<td>1985</td>
<td>−6.9</td>
<td>1994</td>
<td>5.8</td>
<td>2003</td>
<td>8.7</td>
</tr>
<tr>
<td>1986</td>
<td>7.1</td>
<td>1995</td>
<td>−2.8</td>
<td>2004</td>
<td>9.0</td>
</tr>
<tr>
<td>1987</td>
<td>2.6</td>
<td>1996</td>
<td>5.5</td>
<td>2005</td>
<td>9.2</td>
</tr>
<tr>
<td>1988</td>
<td>−1.9</td>
<td>1997</td>
<td>8.1</td>
<td>2006</td>
<td>8.5</td>
</tr>
</tbody>
</table>

levels reached by the end of 2002 are now declining, political support for the pending reforms should now be more forthcoming. But, although these, ‘in principle’, tenets have robust analytical and empirical support, there is not yet a direct causality relationship for all country experiences. If the current (mid-2007) emerging policy framework in Argentina is significantly different from those that came out of Brazil, Colombia, Mexico, Chile or Peru, the question would be ‘why is this so?’ How could Argentina’s learning process be that much different? Mario Teijeiro (2005) insightfully has observed that the ‘failure’ of the Convertibility arrangement may have led to political disenchantment with ‘liberal’ or orthodox policy frameworks. In his view this may already be pushing the Kirchner administration towards the left. Notwithstanding the fact that the collapse of the Convertibility arrangement was more than anything else a failure to meet its fiscal requirements, it may well be that it is still politically profitable to ‘blame the external avatars’ instead of searching for the right lessons and for domestic political accountabilities.

IV. MACROECONOMIC VOLATILITY 1980–1990, LEADING TO CONVERTIBILITY

The period before the adoption of the Convertibility arrangement in 1991 was highly volatile. All-out crisis had erupted in the early 1980s when ‘an overvalued exchange rate had created a large cumulative balance of payments deficit, causing a serious debt service problem and an eventual loss of market access. Inflation accelerated, and real GDP declined by almost 10 percent from 1980 to 1982’ (IMF, 2004a, p. 78). Later on a deep recession ensued, causing real GDP in 1989 to decline by 7 percent from the previous year. During the middle of this crisis, the ruling Radical party lost the national elections, and the administration of President Raul Alfonsin yielded power to the opposition Justicialist (Peronist) party, five months ahead of schedule. (IMF, 2004a, p. 78)

In June 1985 the ‘Austral Plan’ was tried as shock therapy and as a shift away from gradualist approaches. Then in 1988 the ‘Plan Primavera’ attempted to link wage and price controls with a fixed exchange rate. But supportive fiscal mechanisms were not sustained and this attempt also failed. In July 1989 the first Menem administration designed a fiscal and exchange rate package and in October requested a stand-by arrangement (SBA) with the IMF. But by the end of the year, policy control deteriorated and ‘consumer prices rose by 90% during the last three weeks of December’ (IMF, 2004a, p. 79).
President Menem’s first period began on 9 July 1989. In that year GDP declined by $-6.9$ per cent, and by $-1.8$ per cent in 1990. In both of these years inflation was above 2000 per cent. In April 1991, after having ‘tried’ three Ministers of Finance, President Menem appointed Domingo Cavallo. Under his inspiration Argentina adopted in April 1991 a macroeconomic regime anchored on the convertibility of the peso to the US dollar. More broadly the government embarked on a wide ranging program of deregulation and privatization of state owned enterprises.

The answer to the first question on the macroeconomic and political conditions leading up to Convertibility can be summarized as follows. First, a GDP that had been falling for three consecutive years ($-1.9$ per cent in 1988; $-6.9$ per cent in 1989; $-1.8$ per cent in 1990). Secondly, inflation had reached above the thousands in 1989 and 1990. Thirdly, poverty rates in 1990 had more than doubled in five years. These were the conditions and antecedents nurturing a potential political demand for macroeconomic stability and for an institutional transformation of the macroeconomic governance structure.

V. MACROECONOMIC PERFORMANCE IN HISTORICAL PERSPECTIVE

Macroeconomic performance under a long term perspective has not turned out to be good in Argentina. Table 3.2 shows that as far back as 1900 Argentina’s per capita income was one of the highest in the world and twice that of Latin America. This is a country that in 1913 had a higher per capita income than France and Germany (Blustein, 2005, p. 16). From 1950 to 1960 its average annual rate of growth was as low as 1.1 per cent. During the 1980s it had a negative average rate of $-2.4$ per cent (Table 3.3). From 1960 to 2000 its average real per capita growth has lagged behind other Latin American and developing countries (Figure 3.1). Underlying this low growth record and high volatility there is persistent fiscal mismanagement. This was the historical context that inspired the adoption of the Convertibility arrangement. Namely, if the authorities could not print pesos there would not be fiscal deficits, and growth would be high and stable.

Macroeconomic performance measured in per capita terms in Argentina, as well as other Latin American countries, with the exception of Chile, has been lackadaisical or on a declining trend for well over the last 40 years. Figure 3.1 shows that for the period 1960–2000, Argentina’s average real per capita GDP rate of growth has lagged behind Latin America as a whole and other developing countries as well.
Table 3.2  Argentina’s per capita income in regional and historical perspective

<table>
<thead>
<tr>
<th>Region</th>
<th>1900</th>
<th>1913</th>
<th>1950</th>
<th>1973</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>2756</td>
<td>3797</td>
<td>4987</td>
<td>7970</td>
<td>7616</td>
</tr>
<tr>
<td>Latin America (7)</td>
<td>1311</td>
<td>1733</td>
<td>3478</td>
<td>5017</td>
<td>5949</td>
</tr>
<tr>
<td>Western Europe (12)</td>
<td>2899</td>
<td>3482</td>
<td>5513</td>
<td>11694</td>
<td>17412</td>
</tr>
<tr>
<td>Western offshoots (4)</td>
<td>3868</td>
<td>5051</td>
<td>8083</td>
<td>13828</td>
<td>17475</td>
</tr>
<tr>
<td>Southern Europe (5)</td>
<td>1676</td>
<td>1788</td>
<td>2259</td>
<td>6770</td>
<td>10015</td>
</tr>
<tr>
<td>United States</td>
<td>4096</td>
<td>5307</td>
<td>9573</td>
<td>16607</td>
<td>21558</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>4593</td>
<td>5032</td>
<td>6847</td>
<td>11992</td>
<td>15738</td>
</tr>
<tr>
<td>Japan</td>
<td>1135</td>
<td>1334</td>
<td>1873</td>
<td>11017</td>
<td>19425</td>
</tr>
<tr>
<td>South Korea</td>
<td>850</td>
<td>948</td>
<td>876</td>
<td>2840</td>
<td>10010</td>
</tr>
<tr>
<td>Taiwan</td>
<td>759</td>
<td>794</td>
<td>922</td>
<td>3669</td>
<td>11590</td>
</tr>
</tbody>
</table>

Notes:
- Latin America (7): Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela.
- Western Europe (12): Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom.
- European New World (4 called ‘Western offshoots’ by Maddison): Australia, Canada, New Zealand, United States.
- Southern Europe (5): Greece, Ireland, Portugal, Spain, Turkey.
- Data in the table from Maddison (1995) in 1992 PPP-adjusted international dollars. The table shows incomes relative to a Western Europe arithmetic average equal to 1.0. The table shows relative rather than absolute economic performance.

Source: della Paolera and Taylor (2003, p. 4).

Table 3.3  Argentina: equity evolution, 2001–2006

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population below poverty line (%)</td>
<td>35.4</td>
<td>53.0</td>
<td>47.8</td>
<td>40.2</td>
<td>33.8</td>
</tr>
<tr>
<td>Poverty line (%)</td>
<td>12.2</td>
<td>24.8</td>
<td>20.5</td>
<td>15.0</td>
<td>12.2</td>
</tr>
<tr>
<td>Unemployment (%)</td>
<td>20.7</td>
<td>20.7</td>
<td>14.5</td>
<td>12.1</td>
<td>10.1</td>
</tr>
<tr>
<td>Inequality*</td>
<td>0.513</td>
<td>0.528</td>
<td>0.528</td>
<td>0.506</td>
<td>0.501</td>
</tr>
</tbody>
</table>

Note: * Gini coefficient, a higher value indicates an increase in inequality, 2001–2003 Gini are as of May; 2004 and 2005 Gini are as of the second semester.

Sources:
- b. For ‘Inequality’ source see World Bank (2006a, p. 17).
The main explanation for the declining long term trend has been a history of high inflation, fiscal deficits and many failed attempts to establish credibility for economic policies. Behind these external systems there are fundamental political economy problems and weak fiscal and political institutions.

VI. EQUITY AND POVERTY IN PERSPECTIVE

For decades Argentina could pride itself on being a country with relatively low poverty rates in Latin America. But poverty has ratcheted up with each crisis episode. Table 3.3 shows the enormous magnitude of poverty increases resulting from the 2001–2002 crisis. From 35.4 per cent in 1991 poverty jumped to 53.0 per cent in 2002. The extreme poverty line doubled from 2001 to 2002. Inequality as measured by Gini worsened slightly between those two years.

VII. THE 2001–2002 CRISIS IN REGIONAL PERSPECTIVE

The Argentine crisis of 2001–2002 may well have been the most severe one in Latin America during the last 20 years. Table 3.4 compares the experience of Argentina with that of Mexico in 1995 and Chile in 1982. Neither of these countries had four consecutive years of GDP contraction.
If one had to summarize the process that took place between 1995 and 2002, it would be done around the tension between the vulnerability of a convertibility regime and the pressures from ‘fiscal dominance’. At the end the arithmetics (Sargent and Wallace, 1981) of fiscal deficits and growing debt made convertibility unsustainable. From a Knightian perspective the question that arises is why the authorities were not able to protect the inherent vulnerability of the convertibility with risk management of the probabilities of the occurrence of a particular hazard. An airplane is very vulnerable but by managing the risks of potential hazards, planes have become very safe.

Another critical explanatory factor of the crisis was the role played by the IMF. According to Michael Mussa (2002, p. 3) the Fund incurred two important unintended mistakes: (i) ‘Failing to press the Argentine authorities much harder to have a more responsible fiscal policy, especially during the three high growth years following the tequila crisis of 1995’ and (ii) ‘Extending substantial additional financial support to Argentina during the summer of 2001, after it had become abundantly clear that the Argentine government’s efforts to avoid default and maintain the exchange rate peg had no reasonable chance of success.’ However, these mistakes ‘should not obscure the critical failure of Argentine economic policy to run a responsible fiscal policy. This is an old and sad story for Argentina. To satisfy various political needs and pressures, the government (at all levels) has a persistent tendency to spend significantly more than can be raised in taxes’ (Mussa, 2002, p. 6).

But why did the Fund fail to establish the ‘right’ amount of conditionality and ‘catalytic’ financing? Part of the explanation lies in the double role of the Fund as ‘a tough cop’ and as a ‘sympathetic’ social worker (Mussa, 2002, p. 46). Wiesner (2004c, p. 337) observes that all multilaterals perform under ‘Collective Action Restrictions, CAR’s’ which make it very difficult for them to meet what he calls the Resources-Restrictions-Condition (RRC).
dual role is a political24 conundrum resulting from the cooperative nature of the collective action framework within which countries and ‘their’ multilateral institution are created (Tirole, 2002, p. 117). But in the end, it is the lack of domestic political accountability that explains much of the ‘wrong’ risk taking with which some developing countries manage their chosen or endowed vulnerabilities. As long as Latin American developing countries can blame the external avatars for their misfortunes and can do this with political impunity there may not be sufficiently ‘right’ incentives to be more judicious in managing sudden stops or business cycles. If Argentina now draws the wrong conclusions and blames those avatars it will be because the political incentives reward, at least in the short term, those policies.

VIII. FISCAL DEFICITS WITHIN MACROECONOMIC COMPLEXITY

The role of fiscal deficits in compromising the sustainability of the Convertibility arrangement is not a simple one. Guidotti (2005, p. 19) argues that

severely limited in terms of instruments by expenditure inflexibility, an inefficient tax system, and by a rigid exchange rate regime in the face of deteriorating external competitiveness, fiscal policy was confronted with serious difficulties in dealing with the dynamics imposed by the Brady deal, the pension reform, and skeletons25 when international capital market turned volatile after the Asian crisis and the Russian default.

Figure 3.2 shows that of

the increase in public debt of 64.1 USD billions in the period 1993–2000 – corresponding to an average deficit of 2.9 percent of GDP per year – a share of 48.3 percent is explained by the pension reform – a contribution to the overall average yearly deficit equivalent to 1.6 percent of GDP – while a share of 40.5 percent of the total is explained by the issue of BOCONes (Bonos de Consolidación or debt consolidating bonds, also known as ‘skeletons’. These were compulsory bonds given to creditors and pensioners.). In sum, assuming an unchanged fiscal policy stance, the pension reform and skeletons can explain almost 99 percent of the increase in Argentina’s public debt during 1993 and 2000. (Guidotti, 2005, p. 15)

Guidotti’s conclusion (2005, p. 20) seems to be a major lesson and warning for several Latin American countries. After all, fiscal reforms, pension reforms and debt restructuring normally take place. What really matters are liquidity constraints and vulnerability to sudden stops.
IX. THE OCCULT FISCAL RE-ELECTION COSTS OR THE ‘MENEM SYNDROME’

The search for a common thread spanning the whole decade of the 1990s that may help explain Argentina’s March of Folly, from success to dismal failure, reveals one that seems to have the potential to do a considerable portion of that. It also illuminates some of the sources of the differences in the way macroeconomic crisis unfolded in other countries in Latin America. It could be called the ‘Menem Syndrome’. In essence, it summarizes the changes that can take place in the whole incentive structure of a given public sector, and the effects those changes can have on the quality of economic policies, when the Constitutional rules of the political game are changed to allow, for instance, for the presidential re-election of the incumbent administration.

President Menem came to power in 1989 supported by Duhalde. He sought his firm re-election in mid-1993 and then again in July 1998. In the first case he got it in 1995. In the second case he did not. Again in 2003 he also ran against Nestor Kirchner on the Peronista ballot. Duhalde, the outgoing President, supported Kirchner. Altogether Menem held the presidency for a total of over ten years, from July 1989 to December 1999. During the first period he and his team may have felt, in good faith, that he should remain in power to assure the continuity of, at the time, successful policies. But this meant a change in the incentive structure across the decision making process in the whole public sector. Controlling fiscal deficits and additions to public debt would have to compete with the need to obtain political support for the re-election.27

Source: Guidotti (2005, p. 15).

Figure 3.2 Argentina: accounting for the pension reform
The question is, in which direction were the incentives stronger? In the often judgmental calls about fiscal risks, in which direction would the decision making process move? How would political accountability be traced back if the decision making process was taking place under ambiguous policy directives?

The hypothesis is that when an incumbent president and his party seek re-election they will have incentives to buy political support with, inter alia, public expenditures and particular favors to special groups. The possible political vigilance of those political forces that may oppose the expenditure policies, or the re-election itself, can be neutralized by short term interests. The vigilance or surveillance of multilateral institutions is also weakened by the ‘cooperative nature’ of those institutions vis-à-vis a member country. The empirical and analytical support for this hypothesis comes from the fact that from 1994 through 2001 annual fiscal targets with the IMF were missed every year. They were missed by large margins, up to 2.0 per cent of GDP even when the economy was growing at rates exceeding the initial forecasts (IMF, 2004a, p. 24).

According to the IMF (2004a, p. 4), ‘An election-driven increase in public spending led to a sharp deterioration in fiscal discipline in 1999. As a result, the stock of public debt steadily increased, diminishing the ability of the authorities to use countercyclical fiscal policy when the recession deepened.’ But the fiscal problems had been brewing long before in the transfer system with the Provincias, in the issuance of debt to finance off-budget expenditures, in the granting of wage increases and limiting downward flexibility, in focusing more on flow fiscal concepts than on stock and debt concepts, and in the accounting for privatization revenues. All this explains ‘why the stock of public debt doubled as a share of GDP between 1992 and 2001, when fiscal deficits appeared moderate and the government was receiving significant revenue from privatization’ (IMF, 2004a, 80). Tejeiro (2001) opines that mistaken fiscal policy was the main explicatory factor for the 2001 crisis.

Not all re-election processes lead automatically to larger fiscal deficits. They lead more to higher public expenditures than to higher taxes to finance those expenditures. After all, higher taxes would have political resistance while other less transparent forms of financing have less opposition. In the case of Brazil, F.H. Cardozo was re-elected, and in his eight years of government, public expenditures grew much faster than GDP. President Lula has not done much that is different but Brazil has protected its overall fiscal balance by a ‘tax and spend policy’ which may explain why this country has been able to navigate the macroeconomic challenges of the last 10 years better. In Peru, Fujimori’s re-election experience was also one in which public expenditures grew fast
but tax revenues also did and the country has done very well in the last five years.

In brief, the net conceptual hypothesis is that changes in the Constitutional and political rules of presidential election games can have very deleterious effects on the incentive structure regulating fiscal balances and the accounting for stock changes of debt. It may affect the direction in which the management of fiscal risks is conducted by domestic authorities as well as by multilateral institutions. In the case of Argentina, the combination of vulnerability coming from the Convertibility arrangement, and the re-election rules change, proved to be devastating.

X. THE IMMEDIATE CAUSES OF THE CRISIS

Argentina’s most severe economic and political crisis in several decades came about through the combination of three sets of factors:

i. the failure of the Argentinian authorities to take early fiscal corrective measures to resolve the conflict between a fixed exchange rate, on the one hand, with fiscal profligacy and capital outflows, on the other;

ii. a large part of the explanation for the ‘fiscal failure’ and for the loss of much-needed macroeconomic flexibility resulted from the re-election climate since the early 1990s and lasted well into the end of the decade. This political-intensive climate engendered intended and unintended ‘wrong’ incentives for higher public spending and for higher risk taking in the decision making process of key economic policies;

iii. the failure of the IMF in the pre-crisis period to resist political pressures to go on supporting a policy framework which had lost the confidence of the domestic and international markets. Between January and September 2001 the IMF made three decisions to provide exceptional financing support up to US$22 billion.

Notwithstanding the decisive importance of the fiscal related factors in gradually building up to the 2001 crisis, this assessment needs to be further illuminated by more precise answers to the following three interdependent questions:

i. First, was the whole decade of the 1990s one of fiscal profligacy? Did things get out of hand by the end of the 1990s and if so why?

ii. Secondly, fiscal failure measured how? Above the line? Below the line? By debt stock changes that came from the recognition of hitherto

iii. Thirdly, was the public sector facing a liquidity or a solvency problem or what possible interpretation or combination of the two? What are the fiscal implications of the relative importance of a liquidity vis-à-vis a solvency problem?

The literature on the answers to these questions is already copious and will grow more over time, particularly as events continue to unfold in Argentina during 2007 and 2008. The hypothesis this book offers for further discussion is that in some critical judgments about how to choose between the different risks inherent in all policy decisions, the political economy factors emerging from the presidential re-election syndrome throughout the decade may well have inclined the preferences in some sectors of the government towards protecting the interest of the incumbent president. Fortunately the task of apportioning causalities and relevant economic and political contexts has already begun within Argentina, in multilateral institutions and research centers across the world.

XI. THE EMERGING POST-CRISIS POLICY FRAMEWORK

The key guiding question to assess the emerging post-crisis macroeconomic policy framework is to ask what has been learned. Since ‘even under the best of circumstances systemic shocks cannot be entirely palliated’ (Calvo and Talvi, 2005, p. 32), how should domestic policies be framed? All the pain and welfare loss of the crisis may largely be redeemed by history if, let’s say, in 2010, and afterwards, events confirm that real learning took place. If this were not to be the case, Argentina would prove again that it cannot put its political house in order. It would remain a country endowed with vast natural resources and very talented and hard working people but with arresting limitations to nurture the right political and fiscal institutions. Martin Wolf (2005), examining the lessons of the debt restructuring of 2005, avers that ‘Argentina is demonstrating once again why it has been both a serial defaulter and long-running economic failure. That may be the least important of the lessons. It is among the most depressing, all the same.’

In August 2003, Congress reformed the legal structure of the Central Bank and established the following institutional characteristics:
i. It is an ‘autarkic’ institution whose primary function is to preserve the value of the currency.

ii. Board members are chosen by the President and approved by the Senate. They are appointed for 6-year periods and can be re-appointed indefinitely.

iii. In implementing its monetary and financial policy it is free from directives from the Executive National power.

iv. Before the beginning of each year it must publish its inflation target and the expected evolution of the flows of money.

v. Quarterly, or each time there is inflation targeting deviation, it must publish an explanation as well as the program it intends to follow to correct the situation.

vi. It exercises financial oversight through the ‘Superintendencia de Entidades Financieras y Cambiarias’.

These nominal characteristics indicate a large degree of Central Bank independence. They also suggest that there is a modality of inflation targeting as well as the authority for the Bank to issue a sort of ‘Open Letter’ to the public whenever the inflation target is compromised. These characteristics suggest that the Bank has ample independence and can employ its open letter mechanism to use its credibility and to establish political accountability. But all this will need to be tested when difficult choices have to be made. After all, there are antecedents of Central Bank independence (a law passed by Congress in 1992) which in the end did not work out as expected.

The question of whether there is inflation targeting is a complex one. In principle, yes, there is. The Central Bank annually announces annual targets but is not fully clear how much of an integrated analytical and operational framework is there to make monetary, fiscal and exchange rate mutually consistent. A very positive feature of the Central Bank’s structures is that quarterly, or whenever it may be necessary, it has to issue to the public a statement explaining the causes of inflation targeting deviation and indicating what it will do to correct the situation.

The real long term reform has to be institutional and political, not so much in the sense of choosing to give independence to the Central Bank or to establish a fiscal surplus rule but in strengthening a culture of legal property rights. One route with great potential to help in this endeavor is the dissemination of information to the public on the results of different interventions. The premise is that a well informed public minimizes the probability of political failures like the one that seems to explain the lamentable March of Folly from 1991 to 2002.

Argentina continues to recover rapidly from the depths of the 2001–2002 crisis. Growth during the period 2003–2006 has averaged about 9.0 per cent, and has reached pre-crisis levels at the end of 2006. ‘Export earnings are higher, tax revenues have increased substantially, fiscal accounts are in surplus, and the Government has restructured three quarters of its debt in default.’ (World Bank, 2006a, p. 11). Table 3.5 shows that growth has been around 9 per cent on average for the last four years. The unemployment rate has been declining steadily from 14.5 per cent in 2003 to 8.7 per cent in 2006. But there are also reasons for concern. The inflation rate remains high and the primary balance of the consolidated public sector seems to be declining.

Table 3.5 Argentina: basic macroeconomic indicators, 2003–2006

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth rate</td>
<td>8.9</td>
<td>9.0</td>
<td>9.2</td>
<td>8.5</td>
</tr>
<tr>
<td>Inflation rate CPT end of period</td>
<td>3.7</td>
<td>6.1</td>
<td>12.3</td>
<td>9.8</td>
</tr>
<tr>
<td>Primary balance consolidated public sector</td>
<td>3.2</td>
<td>5.3</td>
<td>4.4</td>
<td>n.a.</td>
</tr>
<tr>
<td>Primary balance national public sector</td>
<td>2.3</td>
<td>3.9</td>
<td>3.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Current Account (% GDP)</td>
<td>6.3</td>
<td>2.1</td>
<td>3.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Unemployment rate end of period</td>
<td>14.5</td>
<td>12.1</td>
<td>10.1</td>
<td>8.7</td>
</tr>
</tbody>
</table>

Source: Banco Central de la República Argentina (2006).


Argentina continues to recover rapidly from the depths of the 2001–2002 crisis. Growth during the period 2003–2006 has averaged about 9.0 per cent, and has reached pre-crisis levels at the end of 2006. ‘Export earnings are higher, tax revenues have increased substantially, fiscal accounts are in surplus, and the Government has restructured three quarters of its debt in default.’ (World Bank, 2006a, p. 11). Table 3.5 shows that growth has been around 9 per cent on average for the last four years. The unemployment rate has been declining steadily from 14.5 per cent in 2003 to 8.7 per cent in 2006. But there are also reasons for concern. The inflation rate remains high and the primary balance of the consolidated public sector seems to be declining.


Fiscal deficits and fiscal misalignment are not the primary source of macroeconomic crisis. Weak fiscal and political institutions are. In the case of Argentina the traditional inclination to overspend and to overborrow may have been exacerbated by the re-election environment since as early as 1993 when President Menem pressed the political institution for a constitutional change so that he could be re-elected. The question that emerges is what incentives were sent out to the political process. Again in 1998, President Menem pushed for a second re-election. What were the incentives behind fiscal decisions during these five years?

With the benefit of hindsight, it can be concluded that when ‘convertibility’ was adopted, the judgmental error was to assume that there was a political demand not only for low inflation but also for fiscal prudence. In
the event this was not the case. The results of the political process leading to the crisis suggest that the public wanted, or was led to believe, that it was possible to have it both ways: hardly any inflation and no fiscal constraints. Now that factually this seems unrealistic, the key question is, what has been learned from this painful experience?

The crisis of 2001–2002 is an example of the differences between nominal and real institutional characteristics of macroeconomic governance frameworks. In effect, in Argentina in 1992 a law was approved granting independence to the Central Bank and mandating price stability as its main objective. This was the nominal institutional characteristic. But was it the real one? Judged by its results, and with the benefit of hindsight, it appears that the Central Bank was not immune to political pressures to assume more macroeconomic risks than a truly independent Central Bank probably would. In the last analysis, a Central Bank needs the support of a political demand for macroeconomic stability and the attendant political support for fiscal and other policies that would deliver that macroeconomic stability.

The political process in Argentina does not seem to have enough incentives to reward policies that have a higher probability of safeguarding the general welfare than policies that imply high risks for society as a whole. On the contrary, most of the political incentives seem to reward, or are seen as potentially rewarding, ‘opportunistic’ behavior. Political institutions appear to be misinformed or unaccountable for opportunistic interpretation of the information available. In terms of a principal–agent analytical framework this suggests that the ‘principal’, that is the public at large, is an ‘absentee principal’, and that multiple agents can treat public goods such as the credibility of the Central Bank or of the domestic currencies as a ‘commons’ to be dissipated.

Most countries and societies learn from their experiences, particularly from the painful ones, and gradually seek to enhance control of their political and economic institutions and processes. This is less the result of particular philanthropy or gregariousness than of ‘animal spirits’ and of rational self-serving choices to politically capitalize on what the public at large demands. In the case of Argentina the question that arises is why this learning process is still so protracted and fraught with insufficient ‘right’ incentives to politically reward appropriate lesson taking. This is indeed a beguiling question, particularly in the case of a country so well endowed with highly well trained economists and sophisticated research capacity.

Blaming the external avatars, or the IMF, or capital markets and other alleged fiendish actors, is part of the legitimate political game. All countries do a share of that. But in the end, in some Latin American and other
developing countries, after a crisis, there is a modicum of domestic political accountability and potential positive incentives for politicians to capitalize from the errors of competitors. Why is this not fully the case for Argentina? Why do domestic and external Cassandras seem to fail so often, and so little learning take place in this country? The short and somewhat tautological answer is that there is little political accountability for results and that the rules of the political game are ambiguous and do not contain verifiability mechanisms to establish \textit{ex ante} and \textit{ex post} accountability. In brief, the crisis of 2001–02 was largely self-inflicted and largely the result of domestic political failure.

The Argentine political establishment and the public in general welcomed, by and large, the 1991 Convertibility proposal because they had been feeling the pain and welfare costs of hyperinflation and four consecutive years (1985 to 1990) of GDP decline. This was not a counterfactual argument for the costs of macroeconomic mismanagement. It was a potent source of ‘real time information’ on the high transaction costs of the hitherto existing macroeconomic governance structure. With the benefit of hindsight it can now be said that this political support for low inflation and for the promise of positive growth did not necessarily mean a firm support for the fiscal policies that would meet the indispensable fiscal condition for the sustainability of the Convertibility arrangement.

How much political support there was at the time for fiscal prudence, or for the illusion that the country could have it both ways, that is no inflation together with fiscal deficits, is not an easy matter to establish. But most likely there was a firm initial commitment by President Menem and Minister Cavallo to meet this fundamental requirement. After all, they were the ones who proposed and defended it and probably anticipated that there would be political dividends to be reaped from macroeconomic stability. But then, what political factors changed after the success of the initial years?

The tentative answer that this Country narrative offers for further research is that the Menem administration figured that its success should be rewarded (and perhaps its continuity be guaranteed) by immediate presidential re-election. The Olivos Pact in November 1993 by which Menem could be re-elected may have opened the Pandora’s Box of the ‘wrong’ political incentives. From then on it would prove to be very difficult to resist political pressures and incentives to spend and to incur fiscal and monetary risks that would probably not take place under other conditions.

The rest is largely subsidiary. The technical or political misreadings that the International Monetary Fund may have made, the convoluted decision making process at the domestic and international level, and the failures in crisis management, were all important. However, all this would not have
had the impact it had if the political incentives within Argentina had not been under the pressures, in mid-1998, of yet another attempt by President Menem to be re-elected. In brief, the overarching conclusion is that the ‘wrong’ political incentives, coming mostly from repeated presidential re-election dynamics, proved to be devastating for fiscal prudence and are the most important part of the explanation for Argentina’s demise.

Under a more economic theory perspective, the above political economy explanatory hypothesis can be summarized as the triumph of ‘fiscal dominance’ over exchange rate convertibility. But then the question is, how can it be believed that fiscal issues do not have a political origin? The real ‘original sin’ may well be not so much being unable to borrow abroad in domestic currency, but in issuing too much domestic currency based bonds in the domestic markets.

XIV. THE POLITICAL ECONOMY IMPLICATIONS

An understandable but rather unhelpful conclusion would be to make a comprehensive judgment for the totality of the 1991–2002 experience and sum it up as an unmitigated overall failure. The demonizing of that decade does not seem to be the way to go about evaluating and learning from those years. The assessment has to be more specific both in terms of concrete policy measures and in the timing of those measures. Furthermore, the analysis would need to include the real options surrounding each circumstance. Referring to the debacle at the end of 2001, Machinea (2002) has observed that ‘Once an economy has been fully dollarized it is almost impossible to abandon a hard peg without a financial crisis.’ In this approach lies the enormous value of Claudio Loser’s dialogue with Ernesto Tenembaum (Tenembaum, 2004) in which at each step of the way the crisis process unfolds, determined by a number of varied economic, political and almost personal circumstances. Surely, then, the question is, why was an earlier exit strategy not found before? This backward sequenced questioning of specific policy moments and decision making processes can go on for a long time. A final verdict will always need to be nuanced, contextualized and placed in counterfactual developments. Sebastian Edwards (2003, p. 632) puts it well when he warns against all-inclusive negative judgments which would end up missing some of the positive reforms that accompanied the convertibility regime.

A second misguided conclusion would be to say that the fault lies exclusively with fiscal mismanagement, largely with the IMF, with the ‘convertibility’ arrangement, with the global capital markets, with selected versions of the Washington Consensus, or with incompetent local politicians. It will
take some time to attribute possible mistakes. Each actor will need to go on with its internal evaluation task. Each one will have different incentives driving those evaluations and the results will not be the same across institutions or experts. History seldom provides unequivocal answers. The learning comes from the emerging new questions.

A third, unwarranted conclusion would be to fall into the temptation of dismissing the role of markets, incentives and information in framing the direction in which ‘human action’ tends to evolve. At the end of the day, people respond to incentives. The challenge is to identify the incentives, the intended and the unintended ones, and frame policies that are consistent with those incentives. Navajas (2003, p. 356) has summarized it well when he discussed the meaning of a possible ‘new macroeconomic’. His view seems to be that if there is a new macroeconomic in Argentina it has to do mainly with preserving general macroeconomic consistency and creating favorable conditions for investment.

The evaluation process of the Argentine experience and of its crisis in 2001–02 will go on for yet a number of years. On several fronts, particularly in the fiscal and financial ones, there are already well documented findings and conclusions because of the availability of data and significant ‘evaluable history’. But in other areas, documenting and tracing back the decision making processes and figuring out the direction of causalities will prove to be very difficult. This will be the particular case of critical political judgments made within the ‘sanctum sanctorum’ quarters of the IMF, its management, its Executive Board, the US Treasury and, of course, in the Casa Rosada at Buenos Aires. All those political judgments were legitimate and are made all the time. What may well be missing are the evaluability conditions for those judgments to be rigorously traced back to their respective origins. In brief, political accountability will not be easily established because of the unintended or intended ambiguity in those ‘collective action’ decision making environments. The policy implication and recommendation for the future is that enhanced ex ante ‘evaluable political history’ should become the incentive driving the competition for political rewards – or costs – to those whom history will judge to have been right on target or mistaken.

If the main conclusion is right, that is that the macroeconomic governance framework is particularly vulnerable to short term political opportunism, the policy implication is that underlying this situation there is political fragmentation and an information failure. The principal (the public at large) cannot hold its agents fully accountable for the results of their behavior, and the process does not generate sufficient information to engender a different incentive governance structure. That is, there is little political demand for institutional transformation because there is not
sufficient awareness by the ‘principal’ that transaction costs are excessively high and are potentially lower and ‘remediable’. The response to an information market failure is not easy to figure out. One first step is to ascertain the relativities of the location of the failure. Is it more a demand failure than a supply failure? Which combination of the two? And perhaps more importantly, why is it that there are no incentives to reward the search for information and the use of information as a source of enhanced competitiveness?

The main policy implication of the conclusion that the macroeconomic governance structure has been, and still is, particularly vulnerable to short term political opportunism, is that underlying this situation there is political fragmentation and an information failure in the political and economic markets. These three factors are interdependent. Political opportunism is facilitated by a principal (the public at large) that is misinformed about what may have brought about the debacle of 2001–02 and is also misinformed about the causes that are currently bringing down the poverty and unemployment rates. In its turn the real political incentives will tend to reward political opportunism. The public is aware of the high transaction costs it ended up paying for macroeconomic mismanagement but is unclear as to whom to hold accountable. In addition, the temptation to ‘blame the external avatars’ (be they the IMF, the global capital markets or the economic model) is an attractive one to several actors. It can yield political dividends almost right away. It can also lead to ‘interested searches’ for a new macroeconomics. In spite of warnings that, more than a ‘new macroeconomics’, what is needed is to give priority to general equilibrium and to overall policy consistency (Navajas, 2003, p. 356 and Arriazu, 2003a, p. 320), the short term political incentives are there for, once again, the country failing to take advantage of the current recovery to nurture better policies.

Under these circumstances three recommendations emerge. First is a global one on the role of ‘independent’ information in completing political and economic markets. With regard to political markets and the hypothesis posed in this country narrative about the adverse effects of accommodating presidential re-elections, the recommendation is for the private sector and for ‘think-tanks’ to conduct or commission specific research programs on the actual results that Argentina has had with limiting political competition. Much more research is needed on the regulatory framework of political competition, that is on the constitutional rules that, as Persson and Tabellini (2004a, p. 94) insist, are the ones that shape economic policy. The second recommendation concerns the economic markets. Here again there is an information and an incentive problem. These problems are related to the evaluation of what happened, and why, and who can be
blamed for it all. A spontaneous efficient market solution to these competing interpretations and interests may well not yield the macroeconomic policy framework that best serves the long term welfare of Argentina. A major additional effort has to be made in universities, research centers and ‘think-tanks’ inside and outside Argentina to provide factual information and opinions on what happened, why and how the responsibilities should be attributed.

The third recommendation is for policy makers to focus more on the distributive links between pro-growth and pro-poor policies. The premise is that since poverty reductions are currently taking place, some structural pro-growth reforms may find more political tolerance and a favorable environment. This is the time to adopt, as Artana (2003, p. 21) advocates, long term countercyclical fiscal rules and flexibility in the other key variables such as the exchange rate and the levels of public expenditure.

All research methodologies and attendant results can be questioned. It would be naïve to assume that an undisputed hypothetical tribunal can adjudicate causes and accountabilities. The point is that the more plural and varied the search for lessons, and the more intense the political competition for being able to ‘prove to have been right’, the higher is the probability that the emerging policy framework will be the appropriate one. At worst, some ‘falsifiability hypothesis’ will emerge as well as more rigorous baseline scenarios on which to make more credible future evaluations.

NOTES

2. For an examination of ‘populism’ in Argentina see Sturzeneger (1992, p. 142).
4. Between 1945 and 1948 Argentina went from a situation in which it had abundant foreign exchange to one in which it practically defaulted on its external allegations. To Sourrouille (2005, p. 8) this change coincides with the role of Miguel Miranda in the Cabinet of President Juan Domingo Peron.
5. This meltdown is not much different from the one that took place in 1880. See della Paolera and Gallo (2003, p. 369).
6. Such macroeconomic volatility was accompanied by political volatility. In December 2001 protests led to the resignation of President De la Rua who had been in power just a few months. He was replaced on 19 December by the President of the Senate, Ramon Puerta. A few days later he was replaced by Adolfo Rodriguez Saa who, on 23 December, 2001, announced default on the government’s debt to private foreign creditors. On 30 December, 2001, the presidency went, on an interim basis, to Eduardo Camano. Finally, in January 2002, Congress elected Eduardo Duhalde. On 6 January, the Duhalde administration terminated the peso convertibility regime (Blustein, 2005, p. 242).
7. According to della Paolera and Gallo (2003, p. 372), it is in the arena of macroeconomic monetary and fiscal affairs from as early as 1810 that Argentina had serious constitutional design problems.
8. In the mid 1990s a World Bank Country Assistance Evaluation was already warning that ‘the sustainability of the achievements remained in doubt’. See World Bank, (2000a, p. 1).

9. Galiani et al. (2002, p. 1) observe that ‘Two arguments are often encountered in the discussion of the Argentine case: that fiscal policies were inconsistent with the fixed exchange rate (implying that the political system was incapable of adjusting itself to the discipline of budget constraints and let the public debt grow along an explosive path), and that the convertibility regime induced a sustained overvaluation of the currency, and thus was bound to end in a collapse. There are elements of validity in both arguments, but they are incomplete, and cannot provide by themselves the full picture.’

10. According to Talvi (1997, p. 73), ‘In a model in which events are fully anticipated, the response of consumption and tax revenues to the announcement of an inconsistent exchange rate-based stabilization program generates the following pre-collapse dynamics: the rate of inflation falls dramatically, the balance of payments strengthens (the central bank accumulates reserves), the economy booms, (consumption rises), and as a consequence, the fiscal deficit improves and may eventually disappear altogether. In other words, the program will display all of the ingredients of a success story. Furthermore along the path towards the collapse of the stabilization program, the economy displays none of the usual early warning signals that it is headed toward a balance of payments crisis, since there is no fiscal deficit and international reserves are increasing. In contrast to the previous literature about inconsistent stabilization policy leading to a “Krugman type” balance of payments crisis, where the symptoms of an imminent crisis are visible all along, in this model the collapse of the program comes as a “surprise”.’

11. On the political agreements between Menem and Alfonsin leading to the Olivos 1994 Pact on constitutional reform for re-election, see Grondona (2003, p. 138).

12. On the ‘economics of self-control’ see Buchanan (1991, p. 5). He opines that ‘The “economics of self-control” has reached the status of a respectable, if minor, research program, which may be destined to become more important in this era of emphasis on diet, exercise, health and the environment.’

13. ‘In the long run, macroeconomic policy choices can be viewed as a game between past, present and future generations of political rulers and economic agents. Like any other player in this game, a current government takes decisions subject to a set of bestowed restrictions, and will, in turn, bestow new restrictions on the next generation of government. It is here that the intertemporal fiscal constraints matter. In this conception, policymaking is not a static game in which current pay-offs are only affected by today’s decisions. As Thomas Sargent (1986, p. 21) has shown, it is a dynamic game “that requires time to complete and whose current score depends on past actions of the various players.” See della Paolera et al. (2003, p. 46).

14. To Lavagna (2004, p. 115), it is in ‘areas of crisis management and the decision making process’ that some of the key lessons from the 2001–02 crisis can be drawn.


16. Amongst those possible lessons, former Minister of Economy Roberto Lavagna is quoted by Blustein (2005, p. 200) as having said ‘The lesson is, we must pay attention to bubbles.’ See ‘A pit too deep’ in Blustein (2005).

17. For comparison between different country crisis experiences see Calvo and Talvi (2005). See also Calvo et al. (2004).

18. ‘This was the first peaceful transfer of power from one democratically elected leader to another since 1928.’ See Dominguez and Tesar (2005, p. 21).

19. From 1889 to 1929, Argentina had a very similar system based on a legal guarantee that paper pesos could be converted into gold pesos at a fixed rate. See Blustein (2005, p. 14).

20. In answering the question of ‘what went wrong?’, The Economist (2004, 5 June, p. 4), offers the following explanation. ‘According to one school of thought the decline began in 1913, as the Pampas became fully settled: growth slowed because the country proved unable to industrialise and diversify effectively. Liberals, for their part, have traditionally blamed the governments of Juan Perón (1946–1955), with their quasi-fascist pursuit of
autarky and a state-run economy. Leftists have a more precise date: March 24th 1976, when the most vicious dictatorship of South America’s recent history took power. In this view, shared by many of those close to Mr Kirchner, the dictatorship’s economic policy prefigured Menemism, running up unsustainable debt and destroying the state’s capacity to regulate the economy.’

21. For some of the rich literature on the puzzle of Argentina’s economic development going back to 1820, see della Paolera and Taylor (2003, p. 1).

22. See Frank Knight (1921).

23. One can distinguish ‘between vulnerability-based and risk-based approaches to management of extreme events. The word “vulnerability” describes inherent characteristics of a system that create the potential for harm but are independent of the probabilistic “risk” of the occurrence of any particular hazard or extreme event. One can also distinguish between the “risk” of an event and the “risk” of a particular outcome. The latter definition of “risk” integrates both the characteristics of a system and the chance of the occurrence of an event that jointly result in losses. The point is to consider separately vulnerability and risk, and the implications of such a distinction for thinking about the policy and politics of risk and vulnerability management.’ See Sarewitz and Pielke (2002, p. 1).


26. According to Mariano Grondona (2003, p. 137), Menem made it to the Presidency thanks to Duhalde, who contributed with the political support of the Buenos Aires region. Duhalde may have thought that Menem would later on support his bid for the Presidency.

27. See The Economist (2004, p. 4), for references to Menem’s ‘quixotic drive to spend his way to an (unconstitutional) third term.’

28. Commenting on decision making under cooperative undertakings, Tirole (2002, p. 118) observes that ‘Much recent research in economics has emphasized the difficulty of managing organizations on behalf of a highly heterogeneous constituency. Conflicts of interest among the board generate endless haggling, vote-trading and logrolling. They also focus managerial attention on the delicate search for compromises that are acceptable to everyone; managers thereby lose a clear sense of mission and become political virtuosos.’ See his ‘Institutional implications: What role for the IMF?’ in Tirole (2002).

29. Teijeiro (2001) shows calculations of the fiscal balance implied by the increase in public debt that exceed the fiscal flow approach estimates.

30. According to the IMF (2004a, p. 24), ‘The focus of the staff’s analysis and discussion with the authorities was primarily on the fiscal deficit as a flow variable. Although total public sector debt was included as a performance criterion from the beginning, an assumption of overdue obligations was routinely accommodated. The staff did not produce a table providing a convincing connection between fiscal flow variables and the year-to-year change in the debt stock until July 1997. The debt stock per se became the main focus of briefing papers and policy discussions only in late 1999 or early 2000, when the debt-to-GDP ratio began to approach 50 percent. By then, the economy was in recession, and efforts to reduce the debt by running a fiscal surplus were difficult and possibly also counterproductive.’

31. Whether a convertibility rule makes an economy more vulnerable depends on how the risks associated with such convertibility are calculated, managed, and ‘sold’. See IMF (2004a, p. 28, 35, 64).

32. See Webb (2003, p. 189), for the development of similar questions for the case of finances in Argentina’s provinces.

33. According to Kochhar et al. (2003, p. 31), three features distinguish Argentina’s crisis from that of other countries. First, the unilateral debt default. Secondly, the extended period of bank closures and deposit freeze. Thirdly, ‘The forced conversion into pesos of US dollar loans and deposits’.

34. See Velasco (1997, p. 24), for a ‘dynamic context’ in which the level of one variable (for instance debt) determines the choices policy makers actually have.
35. See, for instance, the work conducted by FIEL, Mariano Tommasi at CEDI, The Universidad de San Andrés, the Centro de Estudios Públicos, CEMA Universidad, The Universidad Torcuato Di Tella, The Central Bank of Argentina and others.

36. See Berg et al. (2003, p. 3) on the question of how to achieve monetary policy credibility and price stability after a crisis. One of their key findings is that monetary policy alone cannot stabilize.

37. In Popper (1962, p. 1) he asserts that ‘The essays and lectures of which this book is composed are variations upon one very simple theme – the thesis that we can learn from our mistakes.’

38. Teijeiro (2001) observes that Argentina’s proclivity towards fiscal profligacy is a cultural trait with a long history. It will only change through learning from experience.

39. See Brazil’s Country narrative on ‘Open Letter utilization’.

40. In April 2001 the Central Bank Governor was replaced over an alleged money laundering charge.

41. Heymann (2004, p. 37) posits that further institutional development is needed. In his view Argentina ‘faces an enormous credibility problem’.

42. For a well argued view that debt and convertibility were not the triggering factors in Argentina’s crisis see Fernández (2004, p. 348).

43. See Wiesner (2004b, p. 14), on the political origins of fiscal deficits for the Colombian case.

44. Referring to conflicting institutional dilemmas Loser (2004, p. 67) observed that the IMF and the Argentinian authorities did not fully share a common analytical paradigm. When the IMF pressed for more fiscal correction the authorities resisted arguing in favor of alleged stronger growth. See Tenenbaum (2004, p. 67).

45. According to Williamson (1996b, p. 379), ‘A condition is held to be remediable if a superior feasible alternative can be described and implemented with net gains.’