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# Without Bread or Work in the New Millennium: Effects of Argentine Economic Policy on the Crash of 2001

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# Without Bread or Work in the New Millennium: Effects of Argentine Economic Policy on the Crash of 2001

Senior Seminar: History 499

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The Christmas season of December 2001 witnessed the spectacle of a cauldron of turmoil as panic and economic disaster swept across Argentina. The Plaza de Mayo, based in Buenos Aires, the nation's capital, had borne witness to violence and protests in the past. Now, the Plaza was only one of many locations around Argentina enduring the consequences of the nationwide specter of protest, discontent, and hardship. The International Monetary Fund (IMF) had not distributed much needed funds to Argentina that winter following a failed review of the country's finances. Argentina had soon found itself engulfed in a pervasive and disastrous society-wide collapse following the exit of IMF support.<sup>1</sup>

After the fall of the military junta in 1983 and the return to civilian government, Argentina had utilized neoliberalism as the economic model for their society to use. Neoliberalism had also been the economic model that was used in many post-authoritarian regimes in other parts of the world, such as Eastern Europe, as it was in Argentina, and had met with frequent success throughout the latter half of the 20th century. Following the removal of the Junta in Argentina, the United States, among others, placed pressure on the newly democratic country to adopt neoliberalism with promises of increased wealth and prosperity. While there was a significant decrease in inflation and an increase in economic output by the end of the millennium, there was not only a massive retraction of the economy totaling more than half of the Gross Domestic Product, but a renewed criticism of the neoliberal policies that had been implemented a few years before.

This paper will examine the degree to which neoliberal policies helped the Argentine economy and the how much blame can be attributed to neoliberalism for the economic crash. To that end, this paper argues that the reasons for the crash centered on both the International

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<sup>1</sup> Paul Blustein. *And the Money Kept Rolling In (And Out): Wall Street, The IMF, and the Bankrupting Of Argentina* (New York: Public Affairs, 2005), xvii,1.

Monetary Fund and the fiscal and monetary policies of the Argentine government. In addition, this paper will look at the policies that each Argentine administration did on its own and policies which, to varying degrees, involved Argentina's relationship with the IMF. In order to accurately understand the questions surrounding the economic crisis itself, it is imperative that neoliberal policies and their origins be explained. It is also important to place the crash of the Argentine economy, and the policies associated with the crash, in context with Argentina's long and trouble-ridden economic past.

The origins of neoliberal economic thought rests in the classical liberalism of the 18<sup>th</sup> and 19<sup>th</sup> centuries. Neoliberalism developed as a reaction against mercantilist and other protectionist policies. Most notably articulated in the Scottish Enlightenment philosopher Adam Smith, classical liberalism emphasized the detachment of the state from economic affairs, particularly relating to taxation and regulation.<sup>2</sup>

However, with the advent of the Great Depression serious doubts arose about the viability of classical liberalism. The reaction to this crisis in capitalism was most prominently articulated by John Maynard Keynes. Keynes advocated a more proactive role for government while preserving many aspects of capitalism.<sup>3</sup> More broadly, Keynesian economics believed that during times of recession, governments could create aggregate demand through spending in order to head off prolonged economic downturns.<sup>4</sup>

Some of Keynes most long lasting contributions to economics came as a result of the Bretton Woods conference in 1944. Designed to establish a new standard for post-war

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<sup>2</sup> Manfred B Steger, and Ravi K. Roy. *Neoliberalism: A Very Short Introduction*. (New York: Oxford University Press Inc, 2010), 2-3.

<sup>3</sup> Steger, 5.

<sup>4</sup> Steger, 9.

economics, the Bretton Woods conference created global financial and trade institutions. These new institutions included the World Bank, the General Agreement on Tariffs and Trade, and the International Monetary Fund.<sup>5</sup> The IMF would end up playing an important role in Argentina's growth and decline in the 1990's.

Around the time these agreements were established, neoliberalism was in the beginning stages of development by Friedrich von Hayek of the Austrian school of economics and other free market economists of the Mont Pelerin Society in 1947.<sup>6</sup> The creation of the society was a reaction to what Hayek saw as the increasing popularity of the collectivist ideals associated with the Keynesian economic theory. Advocating against what he viewed as a rising popularity of state-oriented economics, Hayek sought to promote the market as a mechanism for wealth creation in the form of stabilized prices.<sup>7</sup> The free market principles that the Mount Pelerin Society advocated had long-lasting appeal to economists as well as many consequences in the world economy.

Hayek's free market philosophy was popularized in the wake of the stagnation, high inflation rates and widespread unemployment of the 1970's.<sup>8</sup> In the U.S., the man who would later bring neoliberalism to the forefront of economic thought would be Milton Friedman of the Chicago School of Economics. Neoliberalism, as a national model for growth, consisted of three pillars: deregulation, liberalization, and privatization.<sup>9</sup> Only a few years following his Nobel Prize for Economics in 1976, Dr. Friedman's economic dogmas were not only being considered,

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<sup>5</sup> Steger, 6.

<sup>6</sup> With its headquarters in Switzerland, the Mont Pelerin Society to this day still holds meetings around the world. Many of its members have held or went on to hold positions of power.

<sup>7</sup> Steger, 15.

<sup>8</sup> It would be in this decade that one of the most treasured keepsakes of classical liberals, the gold standard, would be fully removed from the U.S. dollar by President Richard Nixon.

<sup>9</sup> Steger, 14.

but put into practice by the United States and other governments.<sup>10</sup> Despite this meteoric rise of neoliberal philosophy, Keynesian economic institutions would continue to play a role alongside neoliberalism in international economic affairs.

Neoliberalism in Argentina found fertile ground following the collapse of the military government and the turbulent period of the 1980's. In 1981, Lorenzo Sigaut, the Argentine finance minister for the Junta government, had ordered a thirty percent devaluation of the Argentine peso in addition to a twelve percent export tax on agricultural goods. This essentially caused confidence in the peso to collapse. Despite this official reduction in the value of the peso, most Argentines took little notice of the change in value.<sup>11</sup> Argentina had been no stranger to inflation. Throughout the 19<sup>th</sup> and 20<sup>th</sup> centuries, Argentina had suffered through numerous economic crises that resulted in high inflation.

By the end of 1981, Argentina had issued another devaluation of thirty percent. Efforts by the central bank to help save the peso were ineffective as Argentines rushed to trade their diminishing peso for more desirable American dollars. By the end of the year, Argentina faced a foreign debt of 32 billion dollars. In addition to this, Argentina faced a drop in gross fixed investment of 16.4 percent.<sup>12</sup>

Further compounding the economic problems of the Junta government, the military defeat resulting from the Falklands War in April of 1982 left Argentina with an inflation rate of at least 100 percent. Reynaldo Bignone, a retired general, ordered interest rate controls which

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<sup>10</sup> Steger, 17,23.

<sup>11</sup> Paul H Lewis. *The Crisis of Argentine Capitalism*. (Chapel Hill: The University of North Carolina Press, 1990), 477. It is interesting that the Argentine government spent a total of 310 million dollars in exchange reserves in their failed efforts to save the peso. When Argentines got word of a possible second devaluation, there was a run on the exchange market that totaled 308 million dollars.

<sup>12</sup> Lewis, 477.

had the unwanted effect of causing massive spending by the Argentine population in anticipation of inflation. The controls were intended to spur an increase in borrowing in order to grow the private sector, but those efforts were not effective. As a result, the clear inability of the government to administer the economy resulted in Bignone calling for elections the following year.<sup>13</sup>

When democracy was restored in October of 1983, the Radical Civic Union (UCR) won against the Peronists and installed its candidate for president, Raul Alfonsin, over Italo Luder. On most positions, the UCR and Peronists were nearly the same. The factor that propelled the UCR to victory was that unlike the Peronists, the Radicals had not governed since the hardships between 1973 to 1976.<sup>14</sup>

The Alfonsin administration had large challenges as a result of the economic mismanagement of the Junta government. Inflation was at 400 percent, foreign debt constituted 46 billion pesos, and the economy was contracting at a pace of 4.3 percent per year. To compound this further, the only sector of the economy which had seen any growth during this period was the public sector, which, incredibly, was running deficits and made up one half of the GDP for the Argentina.<sup>15</sup>

Notwithstanding the difficult situation Argentina found itself in, Alfonsin was unsuccessful in getting his measures passed in the Peronist-controlled Senate. The administration was reduced to creating committees that would examine various issues of the economy. These

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<sup>13</sup> Lewis, 478.

<sup>14</sup> Lewis, 480.

<sup>15</sup> Lewis, 480. The government expenditures that made up the massive amount of spending was not solely the fault of the state-owned enterprises. In addition to the enterprises, Lewis identifies military spending from the Junta government and debt servicing as contributing factors to the expenditures.

committees would then report to a coordinating committee which, in turn, would then act as an executive committee. This executive committee would then execute the policies for the economy at large.<sup>16</sup>

During this period of great indebtedness, it was not uncommon for private companies and banks to engage in irresponsible lending practices. As was the case in 1982, the main motive behind the anomalous lending practices during this period was to satisfy the needs of corrupt members of the government<sup>17</sup>

This policy did nothing to stop the rampant devaluation of the peso that was taking place in Argentina. By June of 1985, inflation had reached a staggering 1122.9 percent and with Alfonsin's popularity falling, the administration crafted an economic plan for Argentina, known as the Austral Plan. On the surface, this plan had some noticeable neoliberal characteristics. Expenditures were to be cut, the money supply was to be reduced, and, the government was to increase foreign investment while keeping wage and price controls. Additionally, the Austral Plan sought to replace the old currency with a new one.<sup>18</sup>

For all the apparent seriousness of the plan, Alfonsin and the Argentine government did not intend to make use of the plan in full detail. The reality of the situation was that the plan had more to do with pleasing foreign creditors and the international financial institutions than it did with actually limiting government spending. While the government had managed to increase

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<sup>16</sup> Lewis, 482-483.

<sup>17</sup> Ross P Buckley. "The Rich Borrow and the Poor Repay: The Fatal Flaw in International Finance. *World Policy Journal* 19, no. 4 (2002): 59.

<sup>18</sup> Lewis, 484-485.



revenue by an impressive 105 percent, the public sector only faced about 3.8 percent in cuts.<sup>19</sup>

As a result of this appeasement to foreign creditors, the Austral Plan only helped perpetuate the already poor economic conditions Argentina was facing:

Until he launched the Austral Plan, Alfonsín was unable to get any more money from abroad, and even since then the new loans go chiefly toward paying back the old ones, rather than representing fresh money for investment. Indeed, the rate of investment went down every year since 1981 and was responsible for Argentina's negative growth rate. When coupled with the annual outflow of dollars in the underground economy, it is obvious that the country is being bled of capital.<sup>20</sup>

When it soon became apparent that the Austral Plan was not a plan that the government was going to put into practice, inflation rose up to 16.3 percent, which was about the same as before the Austral plan. Unable to impose government price controls, the Alfonsín administration attempted to encourage businesses to control prices, but to no success. By 1987, inflation had climbed up to 102.4 percent yearly.<sup>21</sup> By the end of the decade, the disintegrating economy in Argentina had changed the nature of the debate. No longer was it a question of whether government expenditures should be cut; the government had to make cuts or face continued economic hardships.<sup>22</sup>

As a solution to the turbulent economic period of the 1980's and early 90's, the United States developed what is known as the Washington Consensus. Noam Chomsky identifies this consensus as "...an array of market oriented principles designed by the government of the United States and the international financial institutions that it largely dominates, and implemented by

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<sup>19</sup> Lewis, 485. Lewis notes that this reduction of spending was due to prolonging payment to public sector suppliers. On page 486, Lewis cites government employee data from the "El Cronista Comercial" quoted in Review of the River Plate. The graph illustrates the inability of the Alfonsín administration to reduce the number of public workers after announcing the Austral program in 1985.

<sup>20</sup> Lewis, 489.

<sup>21</sup> Lewis, 487.

<sup>22</sup> Lewis, 488.

them in various ways--for the more vulnerable societies, often as stringent structural adjustment programs.”<sup>23</sup> Indeed, following the economic hardships of the 1980’s, Argentina was a prime candidate for such neoliberal reforms.

This Washington Consensus was predominantly directed toward Latin America by encouraging these countries to adopt neoliberal policies.<sup>24</sup> The name Washington Consensus was a term originally coined by John Williamson to describe what was considered to be beneficial economic policies for Latin American nations by Washington D.C.<sup>25</sup> These beneficial economic policies consisted of ten goals: small budget deficits, reductions in public expenditures, tax reforms, financial liberalizations, competition in exchange rates, the liberalization of trade, the promotion of foreign investment, the privatization of state enterprises, deregulation, and the protection of property rights.<sup>26</sup>

Following the ineffective Alfonsín administration of the 1980’s, Carlos Menem, of the Peronist Party, won the presidency in 1989.<sup>27</sup> Menem, born of Syrian immigrants, previously had served as governor of the La Rioja province from the period of 1983 to 1989. Despite La Rioja being considered one of Argentina poor provinces, Menem managed to build many public works such as schools and hospitals, using the national government to carry the overwhelming cost of the burden.<sup>28</sup> Menem’s long record of support and affiliation with Peronism made it all the more

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<sup>23</sup> Noam Chomsky. *Profit over People: Neoliberalism and Global Order*. (New York: Seven Stories Press, 1999). 19-20.

<sup>24</sup> Steger, 19.

<sup>25</sup> John Williamson. “The Strange History of the Washington Consensus.” *Journal of Post Keynesian Economics* 27, no. 2 (Winter, 2004-2005): 196.

<sup>26</sup> Steger, 19-20.

<sup>27</sup> The Peronist Party over the years has had many different names but continues to be popularly referred to as Peronist.

<sup>28</sup> Blustein, 22-23.

surprising when, after assuming office, Menem went against his party's beliefs in strong state participation in the economy and began pushing the neoliberal policies of the Washington Consensus and IMF when elected president of Argentina.<sup>29</sup>

This shift in the direction toward free market orthodoxy unfolded in rapid fashion. To the international community, the new path that the Argentine government was taking was highly positive. The change in economic policy was reflected in the government officials that composed the Menem administration. The appointment of Domingo Cavallo, a Harvard-trained economist, prompted a thirty percent rally in the stock market following the announcement of his new job as Argentina's Economy Minister.<sup>30</sup>

Cavallo was encouraged to create a new gold standard for the country which would have entailed pegging the value of the peso to gold. Rejecting the use of gold, Cavallo enacted a different convertibility program in 1991 as a new solution to the instability of Argentina's currency. Under this plan the peso was to be linked to the United States dollar. There were a number of good reasons for this course of action. Most of all, it was thought that if the dollar was a legal currency in Argentina, and if the Argentine peso could be exchanged on a 1:1 basis with the dollar, the Argentine government would have a great incentive to protect the currency by being fiscally responsible.<sup>31</sup>

Fixing the value of the peso was widely heralded as the strategy that would save Argentina from its continuing cycle of economic disasters.<sup>32</sup> However, Argentina was foregoing a cherished ability of nations, for no longer did it have the ability to print money in order to

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<sup>29</sup> Steger, 103.

<sup>30</sup> Blustein, 13.

<sup>31</sup> Blustein, 14, 19-20.

<sup>32</sup> Blustein, 21.

stimulate the economy in the event of an economic meltdown. The result of this action was that “the Argentine central bank was legally bound to put itself on a sort of autopilot. As far as Cavallo was concerned, this was a desirable restraint.”<sup>33</sup> This plan was met with skepticism by the IMF. In the previous decade alone, the Argentine government had gone through three different monetary plans that never materialized, leaving the IMF with doubts over the seriousness of this new convertibility program.<sup>34</sup>

Menem, in his neoliberal crusade, removed all price controls on the economy and went about dismantling the various regulatory bodies that oversaw daily economic life in Argentina. The seriousness of Menem’s policies was best seen in his decision to privatize state enterprises, which the Alfonsín administration was unable to do. The number of state enterprises sold reached a staggering ninety percent. Many of the companies would end up going to foreign investors. While the privatization freed the Argentine government from some of its budgetary expenditures, the new owners of those enterprises dismissed about half of the workers previously employed by the state.<sup>35</sup> In total, the money received from privatizations during the period of 1991 to 1997 was twenty-three billion dollars. The Argentine government would use ten billion of that windfall to service the debt.<sup>36</sup>

The Menem administration also set out to engage in trade reforms. These reforms had the aim of increasing the access of Argentine products to markets around the world. Import tariffs

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<sup>33</sup> Blustein, 20.

<sup>34</sup> Blustein, 14-15.

<sup>35</sup> Blustein, 23-24. Blustein also suggests that in Argentina, free markets had great appeal due to the fact that outdated state-run telecommunications resulted in Argentines waiting long periods of time for phone installations.

<sup>36</sup> David McKenzie and Dilip Mookherjee. “The Distributive Impact of Privatization in Latin America: Evidence from Four Countries.” *Research paper for the Poverty and Inequality Unit of the Inter-American Development Bank*. (Puebla, Mexico. 2001), 5.

were reduced to nine percent in 1991, a low rate compared to the forty percent rate of only two years earlier. In addition, the tariff restrictions on capital goods were relaxed in an effort to help encourage and promote new investment in Argentina.<sup>37</sup>

Argentina continued to make economic gains during the early part of the decade. The average Argentine saw their per capita GDP in U.S. dollars increase from 4,636 dollars in 1991 to 7,501 dollars in 1994. In addition, the percentage of people living in poverty dipped from 41.1 to 21.6 percent.<sup>38</sup> The privatization of governmental services resulted in meaningful reductions in the cost of water, electricity, and telephone services for everyday Argentines during the 1990's.<sup>39</sup>

In addition to reducing costs, these reforms helped improve the quality of services, and expand access to these services as well. The privatization of telecommunications resulted in increased service from 3,139,685 lines in 1990 to 6,852,086 lines in 1997. Argentines that had water claims saw their waiting time on those claims reduced from 180 days in 1992-1993 to 32 days in 1994-1999.<sup>40</sup> The effects of these changes can also be seen in one of the great pillars of the Argentine economy, agriculture. During this time, the per capita GDP of Argentine agricultural goods rose from 3,289 dollars in the period of 1985-1989 to 6,294 dollars from 1990 to 1994.<sup>41</sup>

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<sup>37</sup> International Monetary Fund. *Argentina: Recent Economic Developments*. IMF Staff Country Report no. 98/38. Washington D.C. 1998, 5.

<sup>38</sup> Blustein, 25-26.

<sup>39</sup> McKenzie, 13. McKenzie and Mookherjee acknowledge that some scholars use data for electricity up to 1996, before economic instability became evident in Argentina.

<sup>40</sup> McKenzie, 48.

<sup>41</sup> Sergio H Lence, "The Agricultural Sector in Argentina: Major Trends and Recent Developments." In *The Midwest Agribusiness Trade Research and Information Center*. (Ames, Iowa: Iowa State University, 2010), 412.

These economic indicators were certainly positive, but the Argentine government was soon tested in 1995 with the Tequila Crisis. The collapse of the Mexican peso created financial shockwaves throughout the Latin American region. Argentina's response to the devaluation of the Mexican peso entailed both rising interest rates and increasing taxes. The Argentine steadfast commitment to stabilizing the economy did not go unnoticed:

At that point, in the aftermath of the tequila crisis, Argentina finally won the IMF's heart. Within the fund, those who were skeptical of convertibility were on the defensive. In March 1995 an internal staff report had declared for the last time that the Argentines should keep the system...The institution's more positive attitude toward Argentina shone through in public comments by Michel Camdessus, the managing director...“Today, there is no longer any doctrinal divide,”...“My friends, this may not be paradise,”...“But the situation is far better than we would have dared imagine not so very long ago.”<sup>42</sup>

The resulting embrace of the international financial institutions was complemented by a huge influx of foreign suitors vying for financial wealth. Private stocks and private bonds became a sought-after commodity; among those buyers were J.P. Morgan and Merrill Lynch. More often than not, international financiers would send employees to give gifts to government clients alongside their business dealings:<sup>43</sup>

Participants describe the trips as grueling, with meetings and presentations often starting at breakfast and continuing one after the other throughout the day. But the trips also combined business with pleasure...As for Buenos Aires, people familiar with the trips there whisper that a fair amount of entertaining went on at Black, a gentlemen's club across the street from the city's most elegant hotel, which featured scantily clad young women dancing on tabletops and snuggling with customers on couches in the hopes of enticing them to pay for sex.<sup>44</sup>

Investors, however, did express concerns with regard to the convertibility measures placed by the government only a few years before. The concerns with the program were rooted in the fact that the peso was rising alongside of the American dollar and therefore was making

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<sup>42</sup> Blustein, 28-29.

<sup>43</sup> Blustein, 30, 33.

<sup>44</sup> Blustein, 33,34.

Argentine goods less competitive in world markets. To the Argentines who had faced the triple and quadruple digit inflation of the 1980's, going away from the program was not something the Argentines were willing to consider.<sup>45</sup>

The first indications of the possibility of a new Argentine financial crisis were seen in Asia. During 1997, there began a series of global financial shocks involving the withdrawal of investments from the developing world. For the time being however, these disruptions never found their way over to Argentina because of the continued confidence of international financiers.<sup>46</sup>

During that same year, Argentina was still being stabilized by the IMF, in part to promote world financial health during the 1995 Tequila Crisis. To continue ensured stability, the IMF sought out a new program to give confidence to global markets regarding the viability of Argentina's policies. Growing concerns over the long term prospects of the convertibility program prompted some within the IMF to encourage Argentina to decouple the 1:1 exchange of the Argentine peso to the dollar that underpinned Argentina's economy. The new program was developed in light of Argentina's adherence to the dollar/peso convertibility policy. The IMF ended up supporting Argentina's convertibility program in the hopes that the convertibility of the peso would remain sound.<sup>47</sup>

Another condition of this new program by the IMF centered on Argentina's labor laws, which according to the IMF, could undermine the convertibility program due to the rigid nature of the peso. Particularly, the concern on behalf of the IMF was that industry in Argentina could

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<sup>45</sup> Blustein, 35.

<sup>46</sup> Blustein, 37.

<sup>47</sup> Blustein, 42-44.

lose out in competition to other markets.<sup>48</sup> There was, however, a much greater problem that threatened the cherished convertibility of the peso. That problem centered on the spending policies of the Argentine government:

...Argentina was borrowing mainly in dollars, and although that is a common practice in developing countries because of the interest rate advantage, it raised the danger of a financial conflagration that could destroy the dollar-peso link. If the government's debt started looking excessive, markets would worry that the government lacked the dollars required not only to pay its creditors but also to exchange pesos with all comers at \$1 each... In sum, Argentina needed to keep its debt ratios in check, especially the closely watched ratio of debt to GDP.<sup>49</sup>

It would be this interplay between the IMF and Argentina that would help drive the one time prodigy of the IMF into default. The IMF ended up loaning money to Argentina without requiring Argentine structural changes that would have given Argentina a chance to repay the debt. In the end, Argentina could not repay even the interest on the loans they had already borrowed.

When the fashion of investing in Latin America evaporated in the aftermath of the Russian default, the Argentine house of cards collapsed under its own weight. This outcome was almost guaranteed by the problems that occurred as a consequence of the convertibility of the peso with the US dollar. By fixing the Argentine peso to the strengthening United States dollar, the ability of the Argentine economy to adapt to its own economic slowdown became much more limited.

Some problems resulting from convertibility could be seen in Argentina's relationship with Mercosur, the economic union in South America consisting of Brazil, Argentina, Paraguay, and Uruguay. The Mercosur created a trade block for its members by focusing amongst one

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<sup>48</sup> Blustein, 46.

<sup>49</sup> Blustein, 46-47.



another with tariffs only applying to nations outside Mercosur.<sup>50</sup> Forming in 1991, the Mercosur was designed in part as a response to the rise of globalism and to abide by neoliberal economic policies under the Washington Consensus.<sup>51</sup> Even though tariffs were reduced, and those reductions would widen the deficit compared to 2000, the trade deficits that would be accumulated were due more so from devaluations from Argentina's neighbor Brazil.

The IMF had to bear a sizeable degree of the responsibility for the economic crisis that unfolded in Argentina. Before the crisis hit, the IMF had pushed and advocated for many of Argentina's neoliberal reforms. However, the IMF kept loaning money despite the Fund's own warnings over the massive debt Argentina was accumulating. It is important to understand that in critiquing the economic crisis, the Argentine government was behaving in a largely irresponsible manner regarding government spending trends. It was this irresponsible behavior on the part of Argentina, and the cherished convertibility program that were the largest factors in the crash itself. While accumulating debt, the Argentine government did not make efforts to create a broader tax structure, eliminate governmental spending excess, or to crack down on tax evaders. To make things worse, corrupt officials in Argentina mismanaged or, in some cases, stole money.

To say that neoliberal policies were to blame for the large debts incurred by the country would be to also ignore Argentina's long, sad history of debt related crises. Twice in the nineteenth century, in 1824, and in 1890, and again in the twentieth century in 1982, Argentina

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<sup>50</sup>Karl Kaltenthaler and Frank O. Mora. "Explaining Latin American Economic Integration: The Case of Mercosur." *Review of International Political Economy* 9, no. 1 (Mar., 2002): 73. For explanative purposes, Mercosur is an acronym for Mercado Común del Sur, or Southern Common Market.

<sup>51</sup>Michael Mecham. "Mercosur: A Failing Development Project?" *International Affairs* 79, no.2 (March, 2003): 369.

has faced calamitous economic fiascos which rose out of the inability of Argentina to pay back its debts to foreign creditors.<sup>52</sup>

One of the central factors that hindered Argentina from taking the appropriate budget cuts needed to avoid a crisis rested in the relationship of the provinces to that of the Argentine federal government. Under Argentine law, provincial governments were entitled to a portion of the nation's revenue; roughly, this portion of revenue amounted to ten percent of the GDP for Argentina. On a yearly basis, this provincial spending ended up encompassing about thirty percent of the Argentine federal budget.<sup>53</sup>

What made the provisional spending especially difficult was the fact that the funding from the federal government made up about half of provincial government budgets. Of all the provinces, Buenos Aires saw its expenditures more than double throughout the decade, going from 4.1 billion in 1991 to 10.7 billion dollars in 1998. Being in the financial center of Argentina, the increase of spending in Buenos Aires meant an increase in risk to the nation because the province could and would issue bonds to a very eager and willing international market.<sup>54</sup> These bonds compounded the debt of the national government without the national government being able to exercise control over that debt.

The spending cuts that were accomplished on the federal level were undermined by overspending at the provincial level. Argentine efforts at the federal level to cut spending led to a

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<sup>52</sup> Bruno, Eugenio Andrea. "The Failure of Debt-Based Development: Lessons From Argentina." *CATO Journal* 26, no. 2 (2006): 363.

<sup>53</sup> International Monetary Fund. *Lessons from the Crisis in Argentina*. IMF Occasional Paper no. 236. (Washington, D.C. 2004), 13. In addition to his role in formulating this report, Timothy Geithner would later become U.S. Treasury Secretary in 2008 under Barack Obama.

<sup>54</sup> Blustein, 53.

1.25 percent drop in spending as a percentage of GDP for the period of 1997-1999. In addition, provincial public sector hiring, spending, and wages increased about 1.75 percent in GDP, further undermining efforts to control costs at the federal level.<sup>55</sup> Compounding these problems, the Argentine government during the 1990's had an ineffective tax structure whereby the tax base was very small and collection of taxes was limited.<sup>56</sup>

While there were events that the Argentine government could not control, such as the Russian default of 1998, it must be noted that the endemic corruption of the Argentine government played a role in creating the nation's debt. One of the ways in which this can be illustrated is to examine operating cost increases in the provinces. Most notably, provincial spending increased by 25 percent, despite the fact that there was almost no inflation from 1995 to 2000.<sup>57</sup>

Part of this spending at the provincial level can be explained by the shift in social spending responsibility from the federal to the provincial level. After the Menem administration's reforms cut national spending in 1991, the federal government began shifting social programs such as education and housing to the provinces. While federal social services had their annual deficits cut substantially, and were not generating much debt, social spending by the provinces as a whole grew substantively.<sup>58</sup> If the federal government had tried to reclaim the money sent to the provinces, there would have been a risk that the social services in the provinces would have been cut.

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<sup>55</sup> IMF "Lessons from the Crisis in Argentina", 14.

<sup>56</sup> IMF "Lessons from the Crisis in Argentina", 16.

<sup>57</sup> Lindsey Brink, "How Argentina Got Into This Mess." *CATO Journal*, January 9, 2002.  
<http://www.cato.org/publications/commentary/how-argentina-got-mess> (accessed May 7, 2012).

<sup>58</sup> IMF "Recent Economic developments", 25.

Government spending at the provincial level was part of a much larger trend. As a portion of GDP, government spending grew to 21 percent of GDP in 2000 compared to 9.4 percent in 1989.<sup>59</sup> In addition, this spending increase is even more startling when the impact of the reforms of the Menem administration is taken into account. Since the Menem reforms led directly to the privatization of about ninety percent of Argentina's state owned enterprises, by removing these costs, the government had saved a substantial amount of money.<sup>60</sup>

The irresponsible spending on the part of Argentina only continued to get worse as interest payments on the standing debt continued to grow. Interest expenditures as a percent of GDP continued to increase throughout the decade. Initially these interest expenditures were hidden due to the high growth rate of the Argentine economy. When the drop in the growth of the Argentine economy occurred, it was seen as a red flag to the world financial community of the dangers of Argentine debt.<sup>61</sup>

Institutional corruption in Argentina contributed to social divisions within society as well as hindering the ability of the Argentine government to control its debt spending when it became necessary.<sup>62</sup> During the 1990's, many politicians, including President Menem, were suspected of engaging in corruption. During his first term in office, 1989-1995, Argentina faced a staggering twenty scandals and an exodus of high ranking government officials.<sup>63</sup>

The first scandals were rooted in the wave of deregulation which occurred during the early 1990's. Many businesses which were interested in investing in the industries affected by

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<sup>59</sup> Brink, "How Argentina got into this mess", np..

<sup>60</sup> IMF "Recent economic developments" page 4.

<sup>61</sup> IMF "Lessons from the crisis in Argentina" page 8, 10.

<sup>62</sup> IMF "Lessons from the crisis in Argentina" 16.

<sup>63</sup> Luigi Manzetti and Charles H. Blake. "Market Reforms and Corruption in Latin America: New Means for Old Ways." *Review of International Political Economy* 3, no. 4 (Winter, 1996): 677.

deregulation found themselves having to pay for the privilege of doing business in Argentina. The U.S Ambassador to Argentina, Terence Todman, received word from Swift-Armour that Argentine officials demanded bribes in order to freely operate within the country. Menem's own brother-in-law, Emir Yoma, demanded Swift-Armour pay him in order to get approval for a \$115 million dollar investment in the country.<sup>64</sup>

Corruption during this time period also extended into the privatization of state-owned enterprises. Privatizations within the county were highly uncompetitive, oftentimes resulting in the use of bribery for the acquisition of state-owned enterprises. In addition, though the outstanding debts from of these enterprises were being repaid, the payments were being administered selectively. This was the case in 1990, where ENTel, the state telecommunications company headed by Maria Julia Alsogaray, paid two of its suppliers a total of sixty-six million dollars in debt, while neglecting other creditors. Government collusion in this manner resulted in a congressional investigation whose findings were sent to the Fiscal Tribunal.<sup>65</sup>

Corruption involving collusion and lack of transparency was seen in other instances of privatizations, such as the highway system. Details over the privatization of nearly 10,000km worth of roads were largely unknown in congress. Publicly, it was said that the privatization of the highway system would allow the new private owners to charge \$1 for 100km of road. However, there were allegations that Minister Dromi, the Argentine economy minister, had allowed the private company to charge more than double after the privatization.<sup>66</sup>

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<sup>64</sup> Manzetti, 678.

<sup>65</sup> Manzetti, 678. As we will see in the corruption surrounding the Supreme Court of Argentina, the Fiscal Tribunal was made inept by the Menem administration. Hearings concerning allegations of collusion never got any foothold within the system.

<sup>66</sup> Manzetti, 679.

Menem himself was arrested on allegations relating to the arms trade. He was later exonerated by the Supreme Court, which was largely made up of justices who owed their appointments to him. He had placed four justices on the Supreme Court while expanding the number of justices from five to nine.<sup>67</sup> From a cynical viewpoint, it is not difficult to understand how critics of Menem could see corruption in the judicial system. In a corruption scandal surrounding the sale of Aerolineas Argentinas to the Spanish owned Iberia, it took just a few minutes for the Supreme Court to rule in favor of the Menem administration.<sup>68</sup>

The Argentine convertibility program's goal was to establish a strong currency that would firmly stabilize the Argentine peso, but instead produced instability. The convertibility program created a currency board with an explicitly legislated, fixed exchange rate to the American dollar. This new policy meant that only with new legislation could the exchange rate be modified. The currency board was required to provide full backing in U.S. dollars for any new or old issue of the peso, and the U.S. dollar was established as legal tender within the Argentine economy.

In the short term at least, the plan met with spectacular success. Inflation plummeted, dropping 17.5 percent in 1992, to 7.4 percent in 1993, to 4.2 percent in 1994, and virtually zero for the rest of the decade.<sup>69</sup> As a result of the stability, average wages for the Argentine worker saw an increase of fifty to sixty percent from 1989 to 1995.<sup>70</sup>

The plan worked well for most of the 1990's. Later, when potential problems emerged, they might have been controlled if Argentina had only expanded the money supply

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<sup>67</sup> Brink, "How Argentina got into this mess", np.

<sup>68</sup> Manzetti, 678.

<sup>69</sup> Blustein, 21.

<sup>70</sup> McKenzie, 29.

conservatively while carefully decoupling the value of the Argentine peso with the U.S. dollar. Unfortunately as signs of problems became evident in the 1990's, the interest rates that Argentina had to pay became higher, in part due to a strengthening U.S. dollar.<sup>71</sup>

A high percentage of these payments needed to be made just in order to keep up with the interest payments on their debt, but easy access to foreign funds changed due to Russia defaulting in 1998. As Blustein notes,

The shock of the default by Russia, a country once assumed to be too geopolitically important to fail, had driven many investors to abandon their bets on developing countries. "Crossover Investors"- large pension funds, insurance companies, and other institutions that had allocated a few percentage points of their assets to emerging markets during the heyday of the mid-1990's- were switching back to safer, blue-chip havens. "Dedicated investors," such as mutual funds established for the specific purpose of investing in emerging Asia or Latin America were suffering demands for redemption's among their customers. The result was a sharp drop-off in demand for emerging-market securities of all kinds. Private capital flowing to major Latin American countries"... which had totaled about 5 percent of their collective GDP during the boom period of 1997 to mid-1998, shriveled to less than 1 percent of their GDP by mid-1999.<sup>72</sup>

With dollars in short supply and the value of the peso under very severe pressure, the Argentine economy began to unravel. The story of the collapse of the peso is a sad one for the Argentine economy and the people of Argentina. Banks froze accounts that were guaranteed to be convertible to U.S. dollars.<sup>73</sup> When citizens were finally able get their money, the peso had become grossly devalued, and continued to fall so wildly that markets did not know what to charge for the products they had to sell.<sup>74</sup> In some cases, such as John Deere farm equipment, the company branch in Argentina decided that it would only accept U.S. dollars as payment.<sup>75</sup>

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<sup>71</sup> Blustein, 198-199.

<sup>72</sup> Blustein, 77-78.

<sup>73</sup> Blustein, 191.

<sup>74</sup> Blustein, 191 .

<sup>75</sup> Blustein, 242.

While many international observers and economists following the crash in 2001 decried neoliberalism as having harmed the Argentine economy, it should not be condemned as a failure. For the most part, the 1990's showed a stark contrast in growth compared to the inflationary and at times hyperinflationary periods of the 1980's. When looking at the failed Argentine economy in 2001, it was not the neoliberal economic policies which caused the crash, but the fiscal and monetary policies that were implemented by the Argentine government and the IMF. It could be argued though, that in having a convertibility program, Argentina was implementing a liberal economic program due to the constraints on devaluation.

It is often forgotten by economists and critics of neoliberalism however, that while Argentina enacted many neoliberal reforms under the Menem administration, it neglected two points of the Washington Consensus, that being small deficits and competitive exchange rates.<sup>76</sup> Even though the IMF was initially opposed to these policies, with particular opposition to convertibility, there was an unwillingness to further challenge the Argentine government to change course following Argentina's survival of the 1995 Tequila Crisis.<sup>77</sup>

It should be noted that two main policy flaws can be identified. First, the IMF should not have continued guaranteeing loans to Argentina in the face of huge spending increases by the Argentine government. The second flaw was in the convertibility program itself. This program achieved what many previous governments had sought to create-- inflationary stability. However, by fixing the price of the peso to the American dollar, the peso became overvalued as the value of the dollar increased, thereby hurting Argentina's export trade substantially.

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<sup>76</sup> Williamson, 199-200.

<sup>77</sup> Blustein, 28-29.



In the early 1990's Argentina enjoyed a competitive advantage in exports due to the strength of its neighbor's currencies. This competitiveness was fragile because Argentina's competitors employed floating exchange rates, while the Argentine peso was linked to the United States dollar. When both Argentina's competitor's currencies dropped and the dollar strengthened, Argentina's advantage in trade disappeared. Consequently, Argentine exports declined dramatically due to the peso's linkage with the dollar. In 1999 Brazil devalued its currency, and Argentina saw the trade deficit between Argentina and Brazil stand at -829 million dollars. The overall trade deficit became so large that Argentina could not service the interest on its own debt. Statistics from the second half of the 1990's support this point: the external Argentine debt to GNP from 1995-2000 climbed from 30.4 percent to 55.67 percent.<sup>78</sup>

The complexity of the neoliberal era in Argentina and the subsequent economic crash can be ultimately divided into internal and external factors. Internally, the Argentine government showed a clear reluctance to change its ways and to adjust to new realities. Externally, the convertibility of the Argentine peso to the dollar linked the domestic condition of the economy with the volatility of external international events, thus limiting the flexibility that the government needed. The result was that the Argentine nation could no longer hold onto the impressive gains that the nation had made during the 1990's.

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<sup>78</sup> Geethanjali Nataraj and Pravakar Sahoo. "Argentina's Crisis: Causes and Consequences." *Economic and Political Weekly* 38, no. 17 (Apr. 26 - May 2, 2003): 1643.

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