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Understanding the Economic Crisis: How Did Argentina Get Into this Mess?

By Martha Farmelo

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BUENOS AIRES, Argentina – Marta Ocampo de Vásquez is a founder of the world-renowned Mothers of Plaza de Mayo. These white-kerchiefed women boldly confronted the brutal military dictatorship of 1976-1983 and to this day demand the return of their disappeared children.

"Look at the economic plan they left us with," she told me. "And look at the state of the Argentine people. A country with such wealth — the granary of the world — and people are dying of hunger! Until recently we said that one hundred children died per day from malnutrition, but today we'd have to increase that number. It's incredible."

After four years of economic recession, 45 percent of working-age Argentines are unemployed or under-employed. More than half of Argentines live in poverty and one in four is indigent. In 2002, the economy shrank by at least 10 percent.

The paint on this monument in downtown Buenos Aires reads, "We are nothing. We want to be everything." The Ministry of Public Works towers in the background.

Yet Argentina is famous for its immense natural resources and highly educated labor force. Seventy years ago, its social indicators were comparable to those of Canada and Australia and better than many countries in Europe.

How did Argentina end up in such a tragic and enduring downward economic spiral?

Overspending: the View From The International Monetary Fund

The answer depends on whom you ask.

Over more than four decades, the International Monetary Fund (IMF) has loaned billions of dollars to Argentina and has watched this economy like a hawk. However, in public statements on the causes of the current crisis, the IMF takes a fairly short-term view.

The Director of its Western-Hemisphere Department and point person for Argentina is Dr. Anoop Singh, a Peter Sellers look-alike and the butt of countless wisecracks in the Argentine media. In an April 10, 2002 press briefing here, he reiterated the long-standing IMF position that, "In our view, failures in fiscal policy constitute the root cause of the current crisis." Fiscal policy refers to the government's spending and its collection of revenues (essentially taxes, notoriously evaded in Argentina). Based on this analysis, the IMF continues to insist on greater budget cuts as a precondition for further loans. It argues that such austerity will revive investor confidence that, in turn, will stimulate economic reactivation, and produce increased taxes.

Since the mid-1950s, the IMF has required a relatively uniform set of policies as a pre-condition for countries with balance-of-payments problems (*i.e.* more dollars going out than coming in): A currency devaluation to make imports more expensive and boost exports, and a reduction in spending. (When the peso is strong, it is expensive for other countries to buy Argentine exports; devaluation lowers the value of the peso.)

In the 1990s, because the peso was pegged to the US dollar, devaluation was impossible and the principal condition for further loans was a series of budget cuts. To make Argentine exports more competitive, the IMF recommended cutting labor costs by eliminating benefits and protections for workers, which led to measures that undid most of the populist labor legislation introduced by President Juan Domingo Perón and his wife Evita between 1945 and 1955.

The IMF's approach continues to be supported by Argentina's far right, including two current Presidential candidates: Ricardo López Murphy, economy minister for two weeks in March 2001, and former President Carlos Menem, who restructured the economy along these lines between 1989 and 1999.

Open Sesame, Close Sesame: Some Historical Background

My partner, Alan Cibils, has been studying and writing about the Argentine economy for the past ten years. While many analysts have a short-term view of today's crisis, he encouraged me to remember Argentina's twentieth-century economic history — which I summarize in three periods called "Open Sesame," "Close Sesame," and "Open Sesame II."

Open Sesame (1900-1945). For most of the first half of the century, Argentina's economy was wide-open to the world, exporting and importing while imposing few tariffs or other protections. It was highly dependent on foreign markets, to which it sold its hallmark products from the vast pampas: tender beef, leather hides, bags of grains and fluffy white wool, and from which it imported machinery, chemicals and other "capital goods" required for production.

The result was two problems that continue to plague the Argentine economy a century later. First, ***those early exports were "primary" products that have little or no "value-added" and hence yield relatively low profits*** — *i.e.* wool rather than sweaters, or leather rather than shoes. Second, ***Argentina's openness made it vulnerable to external shocks*** such as World War II, when it was suddenly unable to import badly needed machinery from countries like the US.

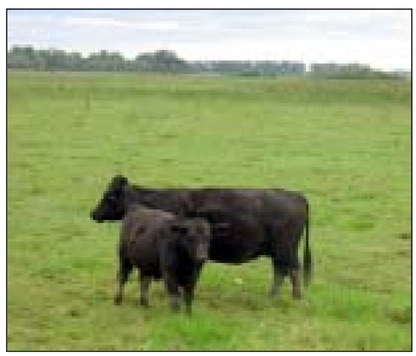
Close Sesame (1945-1976). To address these problems and industrialize its economy, Argentina implemented a strategy called "import-substitution industrialization" (ISI). ISI involves minimizing imports and instead developing *internal* production and markets for industrialized goods. It requires highly protectionist policies such as stiff tariffs and quotas limiting imports that might compete with goods labeled *Industria Argentina* — at least until industry is fully up, running and competitive.

ISI is most associated with the first government of Juan Perón (1945-1955), who is famous for mobilizing the working-class masses and for historic, pro-labor reforms such as the minimum wage, a yearly bonus and health insurance. Many forget that after 1953 or so, he instituted budget cuts that hurt the working class and invited foreign firms to invest and even open factories inside Argentina — and benefit from the profits — a policy consolidated after his overthrow by General Pedro Eugenio Aramburu (1955-58).

ISI did promote industrial growth and to a lesser extent, weakened Argentina's vulnerability to external economic influences. Still, political tension increased during the term of reformist President Arturo Frondizi (1958-61), direct and indirect military control (1961-72), and a brief return of Perón and Peronism (1973-75). And whomever was in power, the ships that arrived to unload ever-more-expensive machines, barrels of chemicals, rolls of steel sheeting and other inputs for industrial production — things Argentina could not yet produce itself — still departed full of ever-less-profitable primary goods like wool and grains. This left Argentina with a shortage of necessary foreign exchange (*i.e.* US dollars), one of the principal weaknesses of the ISI economy.

Open Sesame II: (1976-present). In 1976 a military dictatorship came to power, terminated ISI and instituted a wide opening of the Argentine economy to world trade and finance markets.

Many analysts now argue that overspending is not the main problem and that the roots of the current crisis are far more complex and long-standing. Claudio Lozano is the chief economist for the *Central de los Trabajadores Argentinos* (CTA), a progressive labor federation. Like many Argentines, when asked about this economic catastrophe, he pointed to the day the current economic model was introduced: March 24, 1976, when a murderous dictatorship came to power in a coup that



Argentina is known for exports such as beef and wool produced in its vast, legendary pampas.

overthrew Perón's third wife, "Isabelita."

The military immediately replaced ISI with a classic set of "neoliberal" or free-market policies. Lozano told me, "[This model] is marked by the primacy of financial profit as the central factor that orders the economy and a lack of investment in productivity that led to de-industrialization of the country." The policies included:

- Cuts in the national budget in areas such as education and health care.
- Trade liberalization, that is, the removal of protective tariffs and quotas, which provoked a flow of relatively cheap imported goods into the country, which together with cripplingly high interest rates and an overvalued peso drove numerous local enterprises into bankruptcy.
- Finance liberalization, that is, the lifting of restrictions on capital markets so that foreign investors could enter *and leave* Argentina with greater ease, which opened doors to financial speculation — very short-run investments at high interest rates for quick profits rather than long-term investments that lead to economic growth.

CTA labor attorney Horacio Meguida pointed out that these policies required a relatively docile labor force and that mass murder was used to subdue Argentina's then-militant, presumably left-wing and well-organized labor force. "[These policies] required a genocide," he told me. "More than 30,000 Argentines were 'disappeared'. Strikes were prohibited and union leaders were jailed." Persistent accusations against Mercedes Benz and Ford Motors point up the alleged collaboration of large businesses in the repression.

Still, the dictatorship collapsed more from economic disaster than objections to human-rights abuses. As firm after firm went out of business, industrial capacity shrank by 30 percent and Argentines experienced unemployment for the first time after the full employment of ISI. Between 1976 and 1983, foreign debt increased more than fourfold from $10 billion to $45 billion — but it appears that rather than finance productivity, most of it ended up in private bank accounts abroad. Unions and business leaders began to unite in their protest over the economic calamity.

When President Raúl Alfonsín won the first election in ten years in 1983, he made bold but short-lived attempts to reverse the military's neoliberal policies. He was forced to leave office several months early during inflation so severe that the cost of food would shoot up between the time Argentines entered a grocery store and the moment they got to the checkout counter. The peso was so weak that men and women carried plastic shopping bags full of cash to pay for their goods.

The Menem Years: A Decade of "One-to-One" Dollar-Peso Parity

When the Peronist Party's Carlos Menem became President in 1989, he made a 180-degree turn away from populist campaign promises. During ten years in office he radically restructured the economy, deepening the

Although it seems laughable today, until January 2001 ATM's in Argentina dispensed both dollars and pesos at a one-to-one exchange rate. Though Bank Boston has yet to remove this sign to the contrary, today no ATM dispenses dollars at any rate.

military's record of de-industrialization, indebtedness and emphasis on financial speculation over productive investment.

The centerpiece of his policies was "convertibility," a law that pegged the peso to the US dollar at a one-to-one exchange rate and required that the Central Bank hold one dollar for each peso printed. Until January, 2002, a person could use an ATM to withdraw cash in pesos or dollars — it was all the same. After the trauma of hyper-inflation, convertibility provided much needed currency stability and reduced inflation to zero. However, these policies appear to have done long-term harm to the economy.

Rapid trade liberalization and an overvalued peso. As it had during the military dictatorship, Argentina again opened its markets to foreign goods practically overnight, causing a flood of cheap merchandise from places like China, and giving businesses little time to adjust and become efficient. Combined with a peso pegged to an over-valued dollar, Argentina's exports became too pricey to be competitive in foreign markets, leading to further destruction of industry and the balance of trade. Any trip to the outskirts of Buenos Aires or other spots in the interior means passing one broken-windowed, boarded-up factory after another. Despite years of ISI, Argentina is back to exporting wool rather than sweaters and leather rather than shoes.

No monetary policy. Monetary policy — the control of interest and exchange rates and decisions regarding how much currency to print — is central to how most governments manage their economies. During convertibility, because the peso was tied to the dollar, when US interest rates rose, so did Argentina's. Furthermore, the Argentine government had zero monetary policy. It was as if the US Federal Reserve were to cease to exist and the US economy were suddenly dependent on, say, Japan's monetary policy.

No national currency. The combination of a weak

During convertibility, Argentine exports were hampered by rapid trade liberalization and an overvalued peso.

peso and ten years of thinking in dollars has led to the lack of a viable Argentine currency. Horacio Costa, an economist who works with a Peronist union of construction workers, told me, "In the last twenty years Argentina has cut thirteen zeros from its currency. Who wants this currency? Twenty years ago Argentina lost its local currency as its domestic 'unit of account:' When you asked an Argentine how much his or her house was worth, they responded in US dollars." They still do today.

Because of unstable exchange rates, few Argentines are now willing to save in pesos, which means that few people put money in the bank. If few people put money in the bank, banks cannot make loans and few businesses can operate for long. The effect on the economy is disastrous.

Privatizations. According to Alan Cibils, "Privatization of even profitable state enterprises was taken to ridiculous levels. Mail, airports, the railroad system, the national oil company and all utilities were sold, often at laughable prices. They were mostly sold to foreign-owned corporations, resulting in a shift of extraordinary profits abroad from state coffers." Furthermore, the privatization of the social-security system eliminated an important source of government income, largely from the loss of the interest earned from investing that massive fund.

No capital controls. Alan told me, "Menem removed the few remaining controls on foreign capital and in the early 1990s, investment flowed into Argentina in torrents in search of better returns than those offered by the weak Northern economies. This fueled a boom in consumer credit and demand that resulted in positive growth rates between 1991 and 1994.

"But," he said, "investors spooked by the December 1994 Mexican peso crisis pulled their capital out of Argentina, driving the economy into a deep recession in 1995 that caused unemployment to exceed 18 percent. This 'tequila effect' underscored an important structural flaw of Argentina's neoliberal experiment: the economy's dependence on foreign capital, which could leave the country at vertiginous speeds." Argentina experienced similar economic disasters after the Asian, Russian and Brazilian crises of 1997, 1998 and 1999, respectively.

A crushing debt. According to Claudio Lozano, Menem's economic model was "debt dependent" because it generated far fewer dollars than it required to function, in part because a shortfall in exports led to a shortage of dollars. A second problem was the capital flight described above, when individuals, firms and banks moved billions of dollars out of Argentina into foreign bank accounts — almost all legally.

Since convertibility required that the government provide dollars to whomever wanted to buy them (with pesos, at the one-to-one rate), the only way to keep dollars flowing through the system was to borrow them. Argentina took out billions of dollars of loans from the IMF and private creditors, causing the debt to skyrocket from $62 billion to $142 billion during the Menem years alone. "The 'cupola' [big businesses and other financial interests] holds 140 billion dollars outside of Argentina," Lozano told me. "This is about the same as our foreign debt."

In addition, because its loans had flexible interest rates, Argentina was hit by external hikes in the interest rates on those loans, starting with the US Federal Reserve's decision to increase short-term rates from three to six percent starting in 1994. Eventually, Argentina became stuck in a debt spiral, in which higher interest rates increased the debt and the country's "risk premium" (an increase in the cost to Argentina of taking loans) that led to ever higher interest rates and debt service.

After Menem: The Economic Model Cracks

Fernando de la Rúa, the conservative candidate of the center-left Alianza coalition, beat out current Peronist President Eduardo Duhalde to succeed Menem in the 1999 Presidential election. According to Alan, "he then 'pulled a Menem,' abandoning promises of progressive economic policies and stiff anti-corruption measures. Instead, he administered the economy according to strict IMF austerity guidelines. This included a law called 'Zero Deficit,' requiring the government to balance the budget, though any first-year economics student knows that slashing the budget during a deep recession is entirely counterproductive."

In December 2001, to halt a growing run on bank deposits, de la Rúa issued a now-famous decree limiting cash bank withdrawals to $250 a week. This "*corralito"* (little corral, or play-pen) proved to be the detonating factor for massive discontent. People poured into the streets on December 19 and 20 calling for an end to "*el modelo*" (IMF-sponsored neoliberalism) and the depar-

On December 3, 2001, el corralito *froze most Argentine bank accounts. Most restrictions on bank withdrawals were lifted exactly one year later.*

ture of Economy Minister Domingo Cavallo and de la Rúa, who both resigned.

When seven-day President Adolfo Rodríguez Saá took office on December 23, 2001, he made the dramatic but largely inevitable announcement that Argentina would default on its public debt — with the exception of that held by multilateral lenders such as the IMF and the World Bank. Current President Eduardo Duhalde upheld that default and took the giant and perhaps equally inevitable step of ending eleven years of convertibility by devaluing the peso.

Nonetheless, Duhalde's policies are still "business as usual." It appears his government's only plan for reactivating the economy is to wait endlessly for a new agreement from the IMF. There is no plan for increased public spending, no plan to create new jobs — on the contrary, the IMF has imposed *decreased* public spending as a precondition for further loans. This stands in stark contrast to George W. Bush's $307-billion deficit spending to stimulate the faltering US economy, taking the federal budget from a two percent surplus to a 1.5 percent deficit.

Meanwhile, over the course of this year it has seemed that the IMF keeps "moving the goalposts." Each time Argentina appears to have complied with the IMF's preconditions for an agreement, the Fund raises new issues and demands. Most Argentines have concluded that the IMF has no intention of signing an agreement with the Duhalde administration other than a possible deferment of interest payments. Even Economy Minister Roberto Lavagna has stated that he does not expect any fresh money from the Fund.

Looking Beyond Overspending

In sum, economists of varied political stripes agree that the last 26 years of what Argentines refer to as "neoliberal" policies have been a rotund failure. According to Claudio Lozano, "This is the end of an [economic model] that was installed in 1976. This is not a 'crisis of *conyuntura*'" — *i.e.,* a short-term crisis due to a confluence of factors at this particular moment in time.

Furthermore, while toleration of massive tax evasion is a major problem, data show that the crisis was not essentially a fiscal one. On the contrary, since 1993 Argentina has had a primary surplus. In other words, once debt payments are removed from the equation, Argentina has been running a budget *surplus* and public spending as a percentage of overall Gross Domestic Product has decreased.

Although the IMF would disagree, Alan argues that, "If anything, fiscal tightening probably led to slower

In December, together with pictures of their disappeared loved ones, the Madres de Plaza de Mayo marched under banners such as this that read, "Yes to Life, No Free Trade Zone of the Americas," a stated goal of the Bush administration.

growth, which led to lower government revenue and, to balance the budget, ever less spending. This creates a downward spiral with investor confidence also declining. Rather than fiscal problems, Argentina experienced a deadly combination of external shocks [like hikes in US interest rates and the tequila effect], unrestricted capital mobility and convertibility. Furthermore, both historically and compared to other states, the size of Argentina's national budget has never been disproportionate."

Who Wins? Who Loses?

According to Alan, "Until the mid-1970s, economic policy was a contest over the distribution of income with the main players being labor, industrialists, agrarian interests and the armed forces, but with no clear winners and losers. Then big business and its investors won the distributional battle when the dictatorship came to power in 1976."

According Claudio Lozano, "The [model installed in 1976] has two main characteristics: accumulation of financial profits and resources flowing out of Argentina. And it has two pillars: foreign debt and a state promoting that debt. It has filled the pockets of banks, the privatized state enterprises and big businesses. We're now seeing the end of this model and these two pillars," he added.

"Twenty-five years ago there were twenty-two million inhabitants and less than two million were poor," Lozano said. Today there are 39 million and more than *20 million* are poor. Furthermore, income distribution became increasingly skewed over the last quarter-decade. According to sociologist Artemio López, between 1974 and 1986 the richest ten percent of the population received roughly 15 times that of the poorest ten percent of the population. Today, the richest ten percent receives 34 times that of the poorest ten percent.

Clearly, Argentina is in a state of flux and it is not entirely clear what economic model will prevail — and the fight over the distribution of income has resumed. Each month in Argentina there are hundreds of protests, many of them by unemployed workers demanding jobs and social justice. On December 20, 2002, many of the Argentines that filled the Plaza de Mayo to commemorate the popular uprising that provoked Fernando de la Rúa's resignation carried signs calling for the re-nationalization of privatized utilities and non-payment of the foreign debt.

On December 5 and 6, 2002, the more moderate wing of the Madres de Plaza de Mayo held its annual 24-hour march of resistance. Speaking of the economic crisis and children dying of hunger, Marta Ocampo de Vásquez told me, "This is why we demonstrated with the slogan saying 'Then and now, the struggle is the same.'" ❑

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Fellows and their Activities

Alexander Brenner (June 2002 - 2004) • **EAST ASIA**
A linguist who has worked as an French-language instructor with the Rassias Foundation at Dartmouth College and also has proficient Mandarin and Spanish, upper-intermediate Italian, conversational German and Portuguese, and beginning Cantonese, Alex received a B.A. in History from Yale in 1998 and has just completed a Master's degree in China Studies and International Economics at the Johns Hopkins School of Advanced International Studies. He is prepariing for his two-year ICWA fellowship in China with four months of intensive Mandarin-language study in Beijing. His fellowship will focus on the impact of a new government and a new membership in the World Trade Organization on Chinese citizens, institutions and regions both inside and far from the capital.

Martha Farmelo (April 2001- 2003) • **ARGENTINA**
A Georgetown graduate (major: psychology; minor, Spanish) with a Master's in Public Affairs from the Woodrow Wilson School at Princeton, Martha is the Institute's Suzanne Ecke McColl Fellow in Argentina. Married to an Argentine economist and mother of a small son, she is focusing on economic and societal issues. Martha has been involved with Latin America all her professional life, having worked with Catholic Relief Services and the Inter-American Development Bank in Costa Rica, with Human Rights Watch in Ecuador and the Inter-American Foundation in El Salvador, Uruguay and at the UN World Conference on Women in Beijing.

Andrew Rice (May 2002 - 2004) • **UGANDA**
A former staff writer for the *New York Observer* and a reporter for the *Philadelphia Inquirer* and the Washington Bureau of *Newsday*, Andrew will be spending two years in Uganda, watching, waiting and reporting the possibility that the much-anticipated "African Renaissance" might begin with the administration of President Yoweri Museveni. Andrew won a B.A. in Government from Georgetown (minor: Theology) in 1997 after having spent a semester at Charles University in Prague, where he served as an intern for *Velvet* magazine and later traveled, experienced and wrote about the conflict in the Balkans.

Matthew Z. Wheeler (October 2002-2004) • **SOUTHEAST ASIA**
A former research assistant for the Rand Corporation specializing in South and Southeast Asia, Matt will spend two years looking into proposals, plans and realities of regional integration (and disintegration) along the Mekong River, from China to the sea at Vietnam. With a B.A. in liberal arts from Sarah Lawrence and an M.A. from Harvard in East Asian studies (as well as a year-long Blakemore Fellowship in Thai language studies) Matt will have to take long- and short-term conflicts in Burma, Thailand, Laos and Cambodia into account as he lives, writes and learns about the region.

James G. Workman (January 2002 - 2004) • **Southern Africa**
A policy strategist on national restoration initiatives for Interior Secretary Bruce Babbitt from 1998 to 2000, Jamie is an ICWA Donors' Fellow looking at southern African nations (South Africa, Botswana, Mozambique, Zambia and, maybe, Zimbabwe) through their utilization and conservation of fresh-water supplies. A Yale graduate (History; 1990) who spent his junior year at Oxford, Jamie won a journalism fellowship at the Poynter Institute for Media Studies and wrote for the *New Republic* and *Washington Business Journal* before his years with Babbitt. Since then he has served as a Senior Advisor for the World Commission on Dams in Cape Town, South Africa.

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