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Political Economy in Argentina

The 2002 default: causes and remarks

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1.

Economic policies in Argentina before 1991.

To understand the political economy in Argentina during the 90's – thus the introduction of the currency board- we should start from the post world war II period, analyzing the forty years between the war and the "ley de convertibilidad" (peg to dollar), passed in 1991. Important to our analysis will be not just the political and macroeconomic situation of Argentina but also the cultural background of a country on the edge between both western and Latin cultures. In my personal experience, leaving in Buenos Aires, I had to deal with people who defined themselves European to South Americans and South Americans to Europeans. Which is the truth? Clearly both, being a country whose academic education is very similar to ours, but the lifestyle is deeply identified with the one of the Latin macro region. So it shall be extremely important to take into account the cultural factor to understand why certain economic policies did work or did not work, seeking beyond the pure perspective of macroeconomic data.

Before heading to economical dissertation of the post war period, I'll introduce some characteristics of the political environment in Argentina, important to understand the evolution of political economy. Everything goes around the figure of Juan Domingo Perón, Argentinean president from 1946 to 1955. He came from the army, but he went against the industrial oligarchies creating a lower class movement ("descamisados", literally: without shirt). He pursued socialist policies, with the idea of creating a third view between fascism and communism. However the name of Perón in the modern Argentina (from 1983, after the fall of a military regime) has been used in a populist way, not always coinciding the Peronist party with the ideas of Perón. It depended each time on the leader of the party, which has always been the major one in Argentina, thanks to the power of name of Perón, so loved by the people and still capable of recalling huge masses under its flag. Absurd for the European understandings is that both Menem in the 90's, extreme supporter of liberalism and free markets, and also Nestor Kirchner, socialist, in 2002 belonged and lead this party. In European political terms, Menem's one was right wing peronism, while Kirchner's one was a left wing peronism. The nomenclature “peronism” is just a populist term to attract the masses and win the election.

1.1. **From the end of WWII to 1983**.

This age was characterized by the model of the “Estado desarrollista”, literally a “developer state” even though a more correct translation to English is the “structuralist economics” model.

The model was theorized by the CEPAL (Comisión Económica para América Latina y el Caribe - Economic Commission for Latin America and the Caribbean) a regional organization depending by the United Nations with the aim of promoting growth and integration among the countries in the Latin Area.

The model was essentially an accumulating model (FitzGerald 1998) based on the ISI theory: *industrialización substitutiva de importaciones* – import substituting industrialization.

The government had the role of subsiding and protecting local emerging industries in order to create a national production to satisfy the internal demand, substituting imported products with homemade ones. This kind of politic implied import barriers and high custom duties other than tax benefits to the companies which invested in the local territory.

The CEPAL found out three reasons to enact a structuralist economy. First the difficulties for manufacturing to get access to a competitive market dominated by foreign multinationals and a developed internal primary sector. Then the necessity to rapidly increase the rate of employment, remarking that Latin America, and especially Argentina, received a great amount of European immigrants which represented low cost labor force. Finally the think thank had the idea that just with the support of the central government a sensible improvement in the use and spread of technology would have been possible.

In Argentina the “Desarrollismo” represented the mainstream until the end of the military dictatorship in 1983 when the democracy path restarted with the free election of president Alfonsin. The new Argentinean liberal democracy opened itself to the “western world”, especially to the United States, where the new elected president Regan abandoned the Keynesian principles to manage economy opting for neo liberal approach, which conditioned with a domino effect all the countries under the United States' influence.

In addition to the radical change of the head of the "Casa Rosada" we must tell that the structuralist model did not have plain success. The first step of the program – public investments and protectionists policies – was not followed by a real growth of the industrial production, because of a lack of stability and trust from investors (Fitzgerald 1998). The country suffered an excessive sensibility to external shocks – thing that will not change in the 90's – due to extremely frequent changes in political economy and especially of fiscal policies. The heavy public investments and the general inefficiency of the institutions generated a huge deficit, counterbalanced with inflationary policies which clearly increased investors' uncertainty. Moreover the hoped diversification in new and unexplored production sectors did not show (Ronchi 2010), the model failing in its prime goal: stimulate production in those sectors where the nation depended on imported goods.

It is indeed the fiscal policy the main responsible of the switch of strategy, from a government oriented economy to a more liberal one theorized in Washington in the second half of the 80's.

1.2 The Washington Consensus.

The 80's in Argentina were years of transition, from the dark dictatorship of Videla through a new democratic system under the leader of the radical Raúl Ricardo Alfonsín. Argentina is a presidential republic, so the president is elected directly from the people giving him an important power but also lying on him all the political responsibilities. The main concern of the elected president was to promote a stable democracy, in a country that came out from the "Guerra sucia" (dirty war), meaning the series of persecution violation of human rights and the disappearing of thousands of political dissidents ("desaparecidos"), and also the Falkland war in 1982. It was mainly the defeat in the war and the more than six hundreds Argentinean soldiers who died to make the dictatorship weaver. Indeed the military system collapsed the following year. Facing the outlined scenery, Alfonsin adopted labor policies keeping in mind that the main goal was the social stability. The crisis of 1989, originated from a hyperinflation of 200% was fatal to Alfonsin in the election of that year, the president losing to the peronist Menem, a strong supporter of liberalism.

Still in 1989 the Institute of International economy organized a conference whose topic concerned the best economic policies Latin American countries should purse, in opposition to all the measures adopted in the previous years that did not bring the Area to grow as hoped, remaining its countries under development. The most important paper which showed up from this set of conferences was a work by John Williamson, where was defined a guideline of ten “desirable economic policy reforms”. Desirable to whom? Washington of course. By Washington, the author explains, he refers to the political Washington (the Congress) and also the technocratic side of US heads: international financial institution, government agencies, Federal reserve and respectable think thanks. Of course the “Washington consensus” was not seen by the Americans as an opportunistic way to pursue a neocolonial policy including under its sphere of influence an entire region, but as the best growth path Latin countries should chose to become fully industrialized and worldwide competitors. Several doubts may rise on this point, fact is that in 1989 the Berlin wall fell being the cold war almost concluded. It appears natural that the US looked with particular attention to South America that with Eastern Europe represented in that period two important markets not just for selling but also for direct investments. What they need in Europe was the dissolution of the Soviet Union and the communist model, in Latin America the need was to create a stable and secure market for capitals and investments. Reaching this aim would have benefit both the US and the South American countries.

Now we shall briefly see the ten points of the “Washington Consensus”, pointing out that Williamson himself remarks that his neoliberalism is not as extreme as Thatcher and Regan’s one, with the exception of privatizations.

- Fiscal Deficit. Washington goes against the Ricardian equivalence (expectations make a public expenditure entirely financed by taxation be ineffective on the aggregate demand) and also opposes Keynesian stimulations of the economy by the creation of public debt. The only way to pursue stability, then avoid inflation and capital flight, is the balance of budget.

- Public expenditures priorities. An heritage of Regan presidency is the preference of Washington of a spending review rather than reaching the balance of budget increasing tax revenues. The sectors which deserves public expenditure are education, health and infrastructure. Subsides are to avoid.
- Tax Reform. This is seen as an inferior way to achieve the balance of budget, however it has to be taken into consideration. Especially in Latin America it would be a possibility to tax the assets held abroad, avoiding the sore of flight capitals.
- Interest rate. Williamson believed that the interest rate should have been market determined. Of course to avoid capital flight it must be positive but remain moderate in order to give credibility to the system. He knew however that a market determined rate of interest in Latin America might become extremely high, with the risk of being unsustainable.
- Exchange rate. Here I want to point the attention on since Argentina did not follow this section and later we will see why. Williamson affirms: “In the case of a developing country, the real exchange rate needs to be sufficiently competitive to promote a rate of export growth that will allow the economy to grow at the maximum rate permitted by its supply-side potential, while keeping the current account deficit to a size that can be financed on a sustainable basis”[1]. He suggests that as interest rate also exchange rate must be market determined. Moreover, for a developing country a basic condition for growth is having a competitive exchange rate to shape a space on the international markets. He adds: “A competitive real exchange rate is the first essential element of an "outward-oriented" economic policy, where the balance of payments constraint is overcome primarily by export growth rather than by import substitution”. Argentina traditionally has raw materials to export and as seen before import substituting industrialization did not work, since the traditional sectors grew while no new sectors experienced a sensible hike. In

[1] Williamson J. (1990), What Washington Means by Policy Reform, Chapter 2 from Latin American Adjustment: How Much Has Happened? Peterson Institute for International Economics, Washington, DC. P. 5.

synthesis, having a competitive exchange rate would have been fundamental for Argentina's economy.

- Trade policy. Liberalization of import is key to stimulate internal competition, then production. Also export would benefit from an open inbound market.
- Foreign direct investments. Liberal approach condemns a restrictive policy to foreign direct investment, being this practice a form of protectionism and economic nationalism, practice completely against the free trade principles which the United States support.
- Privatization. There are two good reasons to privatize. The first one is financing the budget with the revenues of the sell from the dismission. The second one is that private managed companies are more efficient than public ones. Argentina followed this policy privatizing all the major public companies, from the airlines (Aerolinas Argentinas) to the oil company YPF. After the crisis of 2001 they were all re-nationalized as a populist policy adopted by Nestor Kirchner first and Christina Fernandez later on. However "Under public control, the financial results of these firms range from mediocre to dismal"[2].
- Deregulation. Deregulating means making the market more competitive, but also making it easier to do business. Bureaucracy and complexity of jurisdictional ordainment are high obstacles to overtake. Simplification is Washington way to stimulate entrepreneurship.
- Property rights. Being sure that the property is guaranteed is basic for investments to grow. The uncertainty of the law augments uncertainty, then country risk, then the rate of interest. Dealing with a high rate of interest is the century old trouble of the Latin countries. It is not just affected by economic policies and laws on paper but also (and above all) on how policies and laws are implemented. At the end of this work we will see how informal institution were very important to explain the default of 2001 in Argentina.

[2] www.economist.com Argentina's state-owned firms. Can YPF avoid the grim fate of other nationalised companies?
May 12th 2012 | BUENOS AIRES |From the print edition

As Williamson will analyze in his later work (2004), in the Argentinean application of this ten points there were two important deviations: As we will see in the next chapter, Buenos Aires in 1991 anchored its currency, “the Peso”, with a fixed parity one-to-one with the American dollar. The Peso was really overvalued and this kind of peg was very far to be the competitive market determined exchange rate which Williamson called for. Truth is that for Argentina in that historical period (200% inflation in 1989) a moderate interest rate was not compatible with a fluctuant exchange rate. However the overvaluation of the “Peso” represented the original sin in the institution of the Argentinean currency board. The country lost competitiveness and at the same time struggled to maintain a sustainable rate of interest for its vulnerability to external shocks (causes and details analyzed in the next chapter). The second deviation, using Williamson words, was that Argentina decided to “liberalize their capital accounts, whereas my version had deliberately limited the call for liberalization of capital flows to FDI”. So doing they accepted the risk of capital flows outside the country, a really high risk in a currency board since the only way to increase money supply is by a surplus of incoming capital.

1.3 The Brady Plan.

The first step Argentina made to follow Washington leadership was to adopt the Brady Plan, from the name of the US treasury secretary Nicholas F. Brady. The plan was a debt restructuring project promoted by the United States government and oriented to all those countries which were experiencing severe fiscal problems due to the stagnation of the “lost decade”(80’s). Argentina was one of those countries. Argentina negotiated its Brady agreements in the April of 1992 after the experience of other five countries: Mexico (the first one in 1989), Costa Rica, Uruguay, Venezuela and the Philippines[3]. All the different state’s agreements had different features depending on their economical situation. The common aspect of the Brady agreements was the increased role of the IMF and the World Bank, which provide financial means for guaranteeing a substantial portion of the bonds issued in

[3] Berthélemy J-C, Lensink R. (1992), *An Assessment of the Brady Plan Agreements,* OECD development centre, working paper No. 67.

exchange for old debt and for repurchasing part of it at a discount".[Also] Some creditor governments (in particular Japan) provide additional financial resources in this context"[4].

"The basic tenets of the Brady Plan were relatively simple and were derived from common practices in domestic U.S. corporate work-out transactions:

(1) bank creditors would grant debt relief in exchange for greater assurance of collectability in the form of principal and interest collateral;

(2) debt relief needed to be linked to some assurance of economic reform and

(3) the resulting debt should be more highly tradable, to allow creditors to diversify risk more widely throughout the financial and investment community"[5].

In addition to that, condition sine qua non was that most (preferably all) the commercial banks had to take part in the agreement, avoiding any free riding risk.

As remarked by Williamson before, the balance of budget was the first point to grant stability to a country and the substantial "haircut" that the plan conceded to the helped governments was a great opportunity to restructure the government debt and to begin a new age of economic policies neoliberal and western centered.

The restructuration of the public balance was possible transforming part of the debt into mainly two kinds of bonds ("Brady Bonds"):

- "Par Bonds resulted from an exchange of loans for bonds of equal face amount, with a fixed, below-market rate of interest, allowing for long-term debt service reduction by means of concessionary interest terms.
- Discount Bonds resulted from an exchange of loans for a lesser amount of face value in bonds (generally a 30-50% discount), allowing for immediate debt reduction, with a market-based floating rate of interest"[6].

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[4] Berthélemy J-C, Lensink R. (1992), *An Assessment of the Brady Plan Agreements,* OECD development centre, working paper No. 67. P. 14.
[5] www.emta.org/background/ The Brady Plan.
[6] www.emta.org/background/ The Brady Plan.

In the end, as a result of an OECD development centre study[7], the Brady Plan was successful in Mexico and in Costa Rica, since it helped them to fix their accounts, giving the chance to this Emerging Market countries a more market-oriented relationship with their creditors. The study was published in 1992, a couple of month later than the Argentinean agreement. It conclude with one certainty: the Brady deals did not have a universal effect and they depended on how they were managed by the different countries, the different contents of the deals and the external situation not common to all the nations. However, the question asked by Berthélemy and Lensink was if the Brady agreements would have had a "confidence boosting" effect on the international markets in the short period. As we will see in the next chapters, despite the liberalized economy, the currency board (ch.2) and the Brady deal Argentina will keep suffering of a lack of international credibility.

[7] Berthélemy J-C, Lensink R. (1992), *An Assessment of the Brady Plan Agreements,* OECD development centre, working paper No. 67.

2.

1991: the currency board.

2.1. Currency board: origins and definition.

The origins of the “currency board agreements” (CBAs) come from the British colonial empire and its desire of creating an homogeneous market among the territories it controlled. In fact the main reason of creating such institution was to promote a trade integration in the empire, a sort of primitive idea of a regional economic and monetary union at the end of the XIX century. The currency boards borne under this idea are called “early currency boards”, and group all the pre-1990 countries which adopted this exchange rate regime. According to Schuler (1992) exist more than 80 currency board agreements of this kind, starting from the oldest ones such as the Seychelles (1849-1966), the Maldives (1849-1967), Singapore (1899-1942), Jamaica (1933-1961) all pegged to the British sterling, or Panama (1904-1931) and the Philippines (1903-1918) anchored to the American dollar. Also after the second world war especially some Arabs countries decides to adopt the strategy of a currency board agreement like, for example, Abu Dhabi (1966-1973) and Bahrain (1965-1973) in the middle east or Brunei (1952-1973) in the Asiatic south east. Interesting is why many countries opted for a currency board after the world war. Most of them were going through an independence process, choosing step by step the best strategy of nation building. It is well-known that ex-colonies emerging states, especially if coming out of long and devastating wars (either civil intestine conflicts or guerrillas against the dominant country in order to achieve independence), do not have a solid economical structure. Their fragile economy would heavily influence their external credibility, increasing the country risk and lowering foreign capital investments. Clearly, without a money flow coming from outside would be quite impossible to physically rebuild a country and start an economic stable growth. These post war currency board agreements lead us to the second reason why the institution is commonly adopted: the raise in financial credibility. Post war CABs might be considered a transition between the early boards (trade integration oriented) and the post 90 ones, based exclusively on the research of “buying credibility” from the anchor currency. Ironically there was just an exception among the early boards and it was the case of Argentina 1891-1935 (Wolf 2008 and other authors). To fight hyperinflation (arrived to a pick of 48% at the end of the triennium 1899-1891) the Argentinean government of the time set up a quasi currency board in the form of the “Caja de conversión” differing from a traditional CBA because of a minimal reserve backing. The board reached its objectives, the inflation lowering to 6 percent in the period 1891-1899 and 3 percent in the following “pre-world war I” period. Because of the external instability of the time combined with the internal political economical situation the Caja de conversión was replaced by a central bank in 1935 and the currency board dismissed. The institution did more than reducing inflation even sustaining a deflationary season in the years 1918-1927 (average inflation rate -3%) and 1927-1929 (-1%). This early Argentinean experience highlights how a currency board can be really effective if there are the external condition to adopt it, but more, the appropriate internal support.

Now we shall technically define the currency board and explain its functioning and design. “Currency boards are identified by three defining features. First, the nominal exchange rate is fixed at a given parity against an anchor currency […] with the domestic money fully convertible into the reserve currency (at least for current transactions). Second, the monetary liabilities of the central bank (and sometimes some fraction of wider monetary aggregates) are subject to a specified foreign exchange backing requirement. Third, CBAs are virtually always codified in law, occasionally even in the constitution, giving rise to very high institutional costs of exiting the board”[8].

This means that a currency board agreement establish a really strict fixed exchange rate regime with no oscillation band (opposite to the EMS in Europe 1979-1998 -1992 for Italy and Great Britain-). In addition to that, the central bank ensures that it is always capable of honoring its liabilities at the parity rate. A good coverage is fundamental for a country which adopts a currency board since it loses the possibility of having its own monetary policies, in particular it cannot augment the monetary aggregates. Money supply and monetary growth then depend on the balance of payments flows. Therefore an external capital “inbound”

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[8] Wolf H.C., Ghosh A.R., Berger H., Gulde A. (2008) Currency Boards In Retrospect And Prospect, MIT Press, Cambridge Massachusetts. P.26.

flow is essential to sustain the economic growth and to avoid the raise of the interest rate, allowing the central bank to act as a lender of last resort (limited) using its excess coverage. In sum to counterbalance the impossibility of printing money (and use monetary measures in general) it is necessary to have reserves in excess (to act likely a lender of last resort) and to ensure capital flows inside the country not to reduce money supply.

Finally, the third feature, law codification of the agreement, enforces the stability thank to a long term purpose of the institution which increases political exit costs, so being quite impossible an abandon of the currency board to the eyes of the market and the financial operators. This last point represents the difference with common adjustable pegs exchange rate regimes. Usually these ones are based on central bank discretional policies, without going through any parliament legislation process, while been ranked as a codified law (or in case a constitutional law) makes the currency board much more credible than a common peg. That is the reason why countries which lacked in credibility think about adopting a currency board exchange rate system, but pegging their own currency to a more strength foreign one is not enough to enable a “credibility growth” path. It is a good start though.

To design an efficient currency board we should consider four points:

- Choose the anchor currency;
- Reserve coverage requirements;
- Choose the parity;
- Consider an exit option.

Electing the currency we want to peg to might seem easy, however there are some issues to take in account. We might prefer a strong international currency, the one of our privileged commercial partner or the one of a country subject to same external shocks. The optimum idea would be that our choice includes all these three conditions. Unfortunately it may be possible that the major trading partner does not have a credible currency as well, or the basic products of the two economies are completely different, being the shocks asymmetric. As we will see in the prosecution of this work, the asymmetry of Argentinean and US shocks were key to understand the raise of Argentinean rate of interest and, later on, its default. How do we choose then? There is no clear answer in literature and each situation should be analyzed in a personalized way. In my opinion, according to Mundell's idea about monetary unions (paragh 1.2.), the main feature is to be sensible to similar shocks with the country we want to peg our currency to. Setting the coverage ratio also present an important trade off. As a central bank coverage ratio it is considered the ratio between bank reserves (currency reserves + stocks of assets) and the total cash outflow (monetary aggregate). Having a high coverage ratio entails providing a lower money supply while if a higher money aggregate is preferred the ratio will definitely be lower. The common value considered to be the minimum to ensure a safe coverage system is 50 percent of the monetary aggregate. However, as we said before a coverage under 100 percent might be a limit for the country which adopt a CBA, since without excess coverage it loses the possibility of acting as a lender of last resort, implying that in a period of crisis the central bank could not support its banking system, whose banks might be forced to close or, less dramatically, to reduce credit concessions provoking a credit crunch and possibly a recession period due to a domino effect. On the other hand a low money supply might not be enough to support the growth knowing that according to the IS-LM model, if the money supply is increased the curve shifts downwards toward the right so that the interest rate decreases and the income increases. Finally, in choosing the coverage ratio it is important to be aware of the macroeconomic situation of the country and act according to it.

The third aspect is represented by the valuation the currency should have in the anchorage process. An undervalued rate would cause in the short period an increase of the money aggregate, then of inflation. On the other hand overvalue the currency would increase the purchasing power but decreasing the money supply we would have to front a higher interest rate. Still, the right choice differ situation from situation, depending on the current status of the country's economy, its political background and informal institutions. Very often economy policies are promoted by technicians who play with models and number, forgetting Keynes "animal spirits", in other words the culture of the citizens of that country. What I mean is that we cannot have inflation in a country whose people are not used to handle it (and fear it), and we cannot pursue austerity policies where there is a high tax evasion rate. Economy growth starts in people's mind, before that on models and law drafts.

The exit option is a safety engine any agreement should have. In the case of a currency

board it does not have to be easy to pursue, because of credibility reasons of course. The only exit option that gives strength to the board is the one oriented to a peg even stronger: dollarization or monetary union. We will come back to it in a few lines. Now we consider the idea of exiting to a more flexible regime. Why and When? If the currency board is abandoned during the developing of a crisis - as the Argentinean experience will tell us – it is too late and the CBA might increase the effect of the crisis, provoking macroeconomic shocks such as a boost of inflation and devaluation of all bank deposits. This case is analyzed deeply from the paragraph 1.2 studying the Argentinean default of the end of 2001.
Anyhow, it is possible to exit the board even during a sane economical cycle, especially if the presumed objectives are reached. In this case in designing an exit option, not to have a bad influence on credibility, it is possible to develop a "target exit". This meaning that the currency board is left after achieving determined results, which stabilize the country and also the image of that country, making it ready to compete on the free market. Of course it will have to handle carefully the instruments that can re-use (monetary policy, lender of last resort) not to lose credibility again and create a negative historical background.
If, on the other hand, the currency board is set with the idea of moving to an harder peg, it is a good start to operate in that direction. "Indeed, in terms of the major institutional requirements for dollarization [or monetary union] –setting the conversion rate, funding the foreign currency circulation, preparing for the loss of exchange rate adjustment tool, and converting existing nominal contracts in domestic currency (Levy-Yeyati and Struzenegger 2003) –currency boards enjoy a substantial head start[9]".
For example Estonia left its currency board and switched to Euro the 1st of January 2011. Opposite to the Argentinean one, the Estonian currency board was well designed, with a clear purpose ahead: escaping from the sphere of influence of Russia after the fall of the soviet union, and orient its economy towards occidental markets, particularly the European Union. In 1992 the current currency was the Russian ruble, affected by depreciation phenomena following USSR fall. Estonia was a new independent state and to gain credibility in the international scene opted for a currency board pegging the new Kroon to the

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[9] Wolf H.C., Ghosh A.R., Berger H., Gulde A. (2008) Currency Boards In Retrospect And Prospect, MIT press, Cambridge Massachusetts. P.53.

deutsche mark with a constitutional law, the “law on the Security of the Estonian Kroon”. Important is the choice of deutsche mark as anchor currency, symbolic union to Western Europe (Lithuania in the same period pegged to US dollar, now to euro). Its performance was great, decreasing inflation and augmenting per capita GDP. The high quality of labor force, the stability of the institutions and undervalued real exchange rate promoted a high capital flow, in the form of direct investments. Moreover, the Bank of England returned deposits retained after the incorporation of Estonia in the Soviet Union that matched with additional funds given by the Swedish National Bank and the Bank for International Settlements granted an excess coverage reserve. This was fundamental to resist Russian 1998 crisis, living a 1 year recession period and an increase of interest rate, to return back on the previous growth path after the “end of the storm”. Not even the failure of Argentinean board a couple of years later sensibly affected Estonian Kroon performance. In 2007 already the country matched European Union’s parameters to join the Eurozone, incorporation that will happen in 2011 as said.
How do we recognize a sane currency board then? We will try to answer to this question in the next paragraph.

2.2. Evaluating a currency board.

To understand how a currency board agreement can be ranked we will comment Camilleri Gilson’s work (2004) based on a seven criteria chart:

- clarity of legal basis;
- quality of reserve backing in terms of denomination and liquidity;
- coverage of the monetary rule;
- vulnerability to alternative claims on reserves;
- operational autonomy;
- transparency and accountability provisions;
- regime revocation arrangements.

Each of this feature is subdivided in subcriteria, coupled to its optimum solution of a theoretical optimum model. Each subcriteria has a value of 1/n where n is the number of subcriteria. The criteria joined together form an index value with base 1.

1) Clarity of legal basis.

A formal and clear institution of the currency board is the first step for the agreement to be credible and efficient. In the constituting law there should be a specific definition of the accord and, better, it should be explicitly defined as a currency board. Only Bosnia and Herzegovina defined its agreement as a currency board, while in the other boards analyzed by Camilleri-Gilson it was just assumed from the description of monetary rules and exchange rate regime. Other than a proper definition, in the statute should be pointed out primary objectives and the type of reserve backing for monetary liabilities. Knowing that the main goal of the country is economic stability and it is constitutional bonded (usually it must be preferred a constitutional law to institute a currency board to strengthen the deal) is a good guarantee for an investor. The transparency of the type of reserve backing also helps a lot on this aspect.

2) Quality of Reserve Backing.

Regarding to this point there are two condition a currency board agreement has to satisfy to be considered efficient: reserve backing assets anchor currency denominated and a mixed portfolio of reserve assets. The first one is logical, anchor currency denominated assets ensure the creditors a non devaluation of their credit. About the diversification of the assets, liquid and risk-free assets equal to the amount to cash in circulation should be held in order to face an eventual crisis so that there would be immediate access to liquidity, while excess coverage should be invested in long term assets to make profits.

3) Coverage of Monetary Aggregates.

As we said in paragraph 1.2, the coverage should be extended to broader money aggregates, in order to support its banking system in case of crisis.

4) Claims on Reserves.

To enhance stability the currency board should be working as a lender of last resort just in peculiar crisis situation. Its function is to monitor and to supervise the banking system, not saving the banks in case of bailouts. More important the second condition: statutory prohibition to lend money to the government. If it were possible, there would be the risk of making public debt by the government, knowing to have its backed covered. The augment of public debt, covered by the CBA might generate instability and inflation, opposite to the aim of the currency board institution.

5) Operational Autonomy.

A currency board cannot be depending on government decisions. The reason is that the currency board is instituted in countries where government policies are not trustable, so it is created an autonomous policymaking authority to solve political inefficiencies. A currency board that depends on a non credible government becomes naturally not credible, thus with no reasons to exist.

6) Accountability and Transparency.

It is easier to trust something easy to know. According to this principle in the statute of a currency board should be included accountability and transparency criteria, in order to track all the institution's operations, with the possibility of evaluating them. This kind of authorities should publish their data on a timely basis, following precise reporting procedures.

7) Escape Clauses.

In defining a currency board it was said that one of the characteristic is that it is a law-based institution. Therefore, there should not be any discretion in revoking the agreement, but strict requiring of parliamentary ruling. This guarantees the idea of long term agreements giving strong assurances to markets and investors. Positive is if the exit clause is oriented in adopting the anchor currency, since set this goal, the possibility of a step back (devaluation) lower.

In sum, a credible a currency board should be well defined at legislative level, the objective well identified and the bank reserves clearly determined so that financial operators can act in clear conditions knowing that their money is under legal protection. Certainty of the right is basic for a country to gain in credibility. In addition to that investors should prefer a CBA where the coverage reserves are anchor currency nominated and are also differentiated (cash and short period assets) in order to generate interest profits, increasing CBA's capital, therefore its stability. A broad monetary supply here is preferred to a narrow one since (as we said referring to IS-LM models) higher is the aggregate lower is the rate of interest, making it advantageous for investments, with the condition of a broader coverage. Really

important is the required prohibition to credit to the government, in order to decrease the possibilities it makes deficit, not having its back covered. We shall see that a high public debt might be hard to be tolerate in a CBA, since devaluating has always been the common tool to cover a high debt in a short period. Of course CBA must be more autonomous as possible, not just in its operational liabilities, but also in the term of retaining the profit it makes in order to accumulate reserves and generate an excess coverage. An investor should also evaluate the real transparency of the institution (other than the formal one). An open data system, where all the operations are shown in detail is to be preferred to a confused one. Many times this is a mirror for the general institutions of the country, not just the CBA, making it risky to invest there. Finally if a CBA does not have a well planned exit option, there is no certainty about its life path. An exit close tied to a target achievement or a time session makes the institution much more serious and credible rather than an open-ended committed one. For example Argentinean objective in adopting a currency board in 1991 was to fight hyperinflation, however it was unclear, ambiguous, the institutions not knowing, neither realizing, which was the correct moment to dismiss it. The Latin country result index according Camilleri Gilson ranking chart ($0<x<1$) was 0.54, meaning that it had just little bit more than half of the requirements a sane currency board agreement should have. The best resulted to be the Bosnian one (which still resists) with an index of 0.93.
In the next paragraphs will be analyzed Argentina's economic background in the years that preceded the institution of the currency board, trying to understand the reasons of the choice.

2.3. The currency board in Argentina

The 27th of March 1991 the "ley de convertibilidad" (law # 23928[10]) was adopted by the Argentinean government under the pressures of its Ministry of Economy, Domingo Cavallo, establishing a fixed exchange rate of 1 USD= 10000 Australes, Argentinean currency of the time. In addition to that the Austral was replaced by the current currency of the Latin

[10] http://www.infoleg.gov.ar/infolegInternet/verNorma.do?id=328

country, the “peso”. It had value 1 dollar, meaning a perfect fixed parity between the two currencies.

The idea of the president of that time, Menem, was to grant Argentina credibility to international investors and beyond this currency agreement with Washington, started a series of liberalization and deregulation politics.

Dani Rodrik (2003) synthesizes very well Menem’s idea with the assumption: “The too simple idea of Sovereign Risk Reduction”.

So doing Buenos Aires renounced to manage its own monetary policy, binding it to the more credible American one, hoping that simply this straight link could be the answer to get out of the crisis of the 80’s and start growing again. Rodrik explains that: “The straitjacket of the currency board regime was the linchpin of this strategy: by linking the value of the peso one-for-one

to the US dollar in 1991, and putting monetary policy on automatic pilot, the regime sought to counteract the effects of more than a century of financial mismanagement”. The strategy ended to be wrong, fact that the country fell in default ten years after the institution of the currency board. To understand this failure a long series of event will be analyzed, that linked with the anchorage of the peso, brought to insolvency at the end of 2001.

However, before going to the main events of the 90’s, we shall briefly remind in 5 points what a currency board is and how the Argentinean one worked:

“*1) Convertibility at a fixed rate. Back assets cover monetary base, but no bank money. There is*

no place to act as a lender of last resort to the commercial banks.

2) It needs reserves (in some proportion) to back issued currency. A fraction is maintained in an

extremely liquid form, to attend conversion claims.

3) Notes and coins issues yield segniorage to issuer. Net income perceived by Currency Board depends on interest on backing assets. And the political value “national currency” is maintained. It is not the case when local currency is entirely substituted.

4) With low trade barriers, local tradable prices are in line with rest of the world goods. Non-tradable could diverge. With capital account openness and in absence of political risk, interest
rates should be approximately the same locally than in the rest of the world.
5) By design, Currency Boards have no discretionary power to exert active monetary policy (Schuler, 1992)".
The peg to dollar effectively fought traditional Argentinean hyperinflation, however during negative economical cycles the real costs to allow the anchorage were extremely high (like during the "tequila crisis" started in Mexico 1994 which spread to the other Latin economies, when Argentina face a period of recession, after 3 years of growth).
The explanation of the necessity of an intense recession in the real sectors of the economy to avoid devaluation might be the following. And from this explanation will come out the original sin of the 2001 default. In the 60's Mundell theorized four requirements to permit a sane currency link:

1) Openness of the economy;
2) Commercial integration between partners;
3) Factor mobility between partners;
4) Symmetry of shocks between both economies.

Mundell's theories nowadays became actual again thanks to the debate about the Euro zone, and the compatibility among its various economies, without the existence of a common fiscal politic. If there are some doubts even about the possibility of coexistence between Italy and Germany, two developed countries but with different systems and traditional ways of managing some economical issues, I believe that clear is how Argentina and the US are far from each other. Of the four points Mundell highlighted only the second one could be considered present enough.
To our dissertation particularly important are points 1 and 4.
We shall see in the following paragraphs that Argentinean economy has not been always opened during the examined period (1991-2002), but the government changed its orientation towards external markets several times, increasing the uncertainty of

investments and then counterbalancing the possible currency board positive effects on credibility.

Furthermore there was not symmetry of shocks between Buenos Aires and Washington, being the former much more sensible to external shocks, especially the ones in the Latin macro region, not that relevant for US economy.

In the next paragraph we will analyze the “tequila crisis”, the political response from the *Casa Rosada* and the fragility of Argentinean credibility despite the currency link.

As some authors[11] demonstrate, it is not the institution currency board which provoked the crisis, but “it is that the monetary discipline engendered by the board can only go so far unless it is accompanied by restrictions on fiscal policies and structural reforms facilitating the adjustment to the inevitable vicissitudes of economic life”. More, the restrictions on fiscal policies were too heavy to sustain for a country, Argentina, with several political inherent inefficiencies, other than an excessive vulnerability to external shocks which made the currency peg not efficient. And here we come again to the “The too simple idea of Sovereign Risk Reduction”[12]: the simplistic view of the governors of the time saw the currency board alone as the solution, however not well managed and in Argentinean contest it became an amplifier for the crisis.

[11] Wolf H.C., Ghosh A.R., Berger H., Gulde A. (2008) Currency Boards In Retrospect And Prospect, MIT press, Cambridge Massachusetts. P. 117-140.

[12] Rodrik D. (2003) From: The Crisis That Was Not Prevented: Lessons for Argentina, the IMF, and Globalization, FONDAD, www.fondad.org. P.16.

3.

The events which lead to the 2001 crisis.

3.1. 1994: the "tequila crisis".

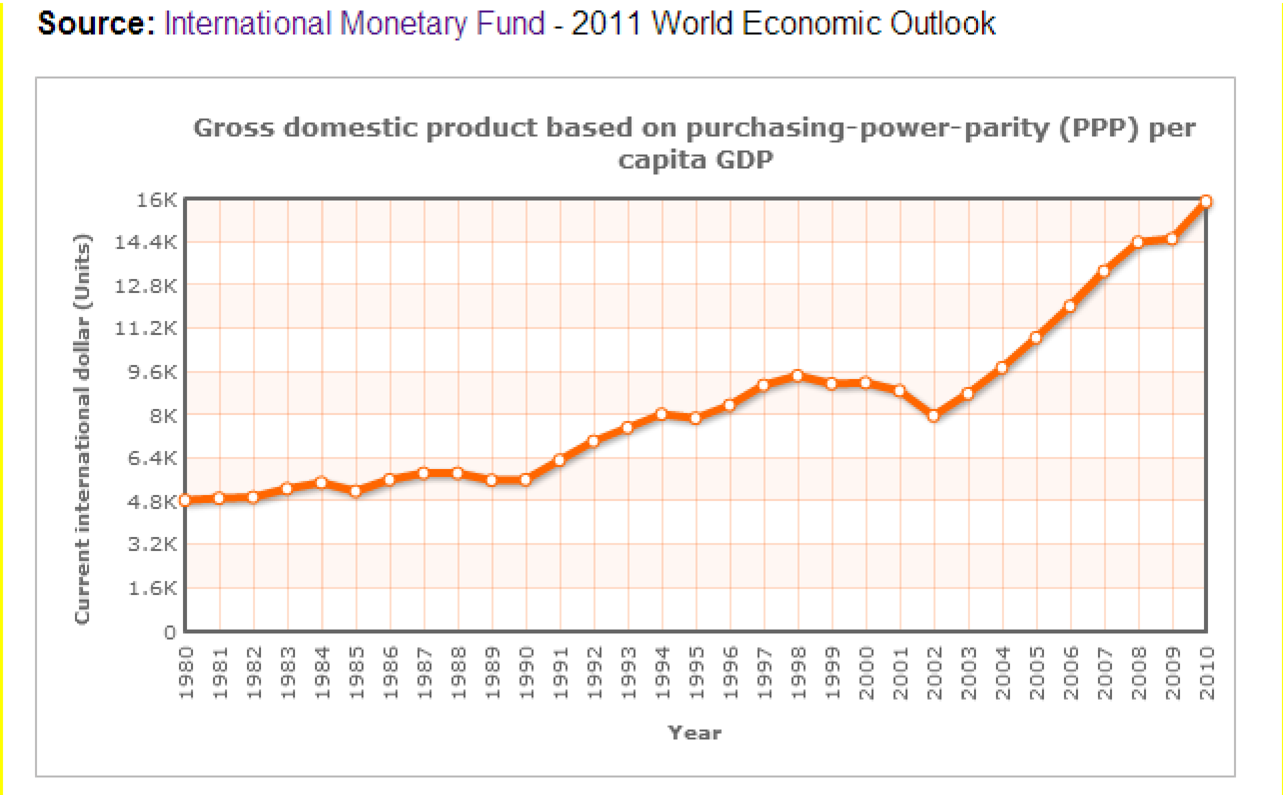
In 1994 Mexico suffered a strong devaluation of its peso (the so called "tequila effect"), having a great impact on the other Latin economies.
The fall of Mexican economy triggered a confidence crisis in Argentina's financial system, being the banking sector the first one to collapse.
Initially the foreign banks in Argentina started a credit crunch policy (Ferro, 2001). Right after the country experienced a crazy run on deposits, with a net withdrawal of 8 billion dollar, the 16% of the whole deposit base ($45.6 billion on December 20). In the first nine months of 1995, 34 banks and 6 nonbanks closed (through acquisitions, mergers, or liquidations), leaving the system with 134 banks and 31 nonbank financial entities[13].
Despite the currency board, as we can see, Argentina's international credibility was not maintained and keeping on the peg with the US dollar provoked recession effects on the real sector of the economy. The GDP fell (-2.04% -graphic 1), and unemployment raised (+ 6.70% - graphic 2).

"The government responded convincing the top 5 banks to create a safety net of 250 million dollars, to buy the assets of illiquid wholesale banks in exchange for lower reserve requirements, followed by another rescue plan of 790 million. To help facilitate the restructuring and consolidation of private banks, the government established a Trust Fund, financed by up to
$2 billion of government of Argentina bonds and a $500 million loan from the World Bank"[14].

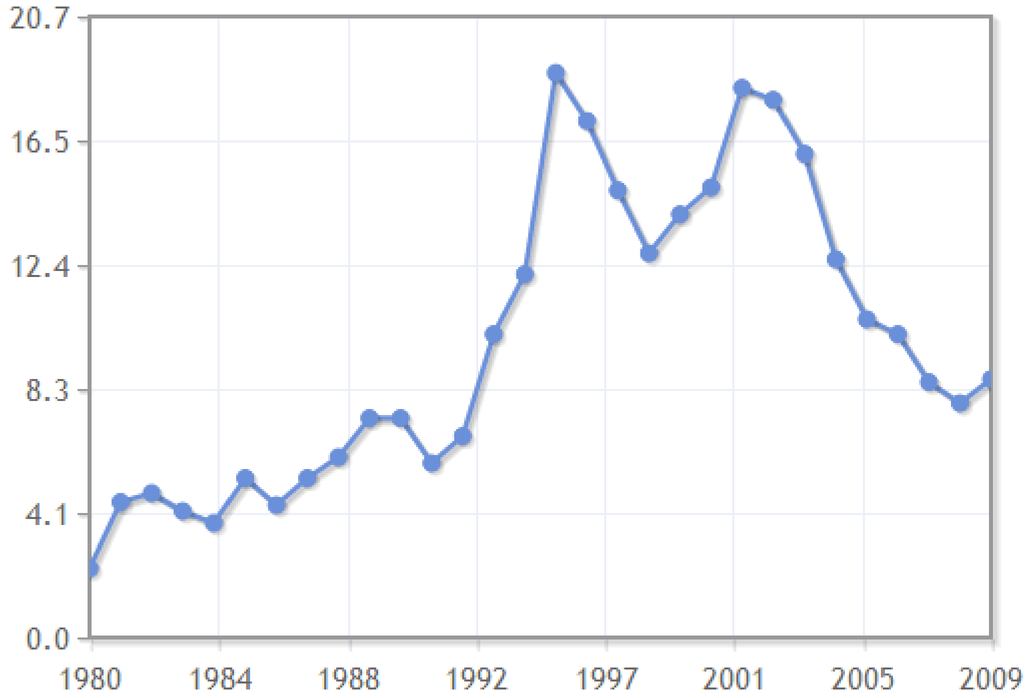
[13] www.imf.org, Finance & Development / March 1996. The Tequila Effect and Argentina's Banking Reform, Carrizosa M., Leipziger D.M. and Shah H. P.24.
[14] http://www.imf.org, News Brief No. 95/10.

The trust found aim was to assist the merger, acquisition and reconstruction of the troubled banks granting loans to the new entities.

Graph. 1



Graph. 2: unemployment in Argentina (Source: indexmundi.com)



In a few months the central bank reserves fell by approximately 5 billion dollars, requiring an IMF intervention to grant liquidity to the Argentinean central bank. The country’s economic program for 1995 was supported by $2.8 billion from the IMF.

Michel Camdessus, Managing Director of the International Monetary Fund said (march 23, 1995):

"This is a strong and coherent program for 1995 that should bolster confidence in Argentina's ability to sustain its remarkable economic achievements of recent years. The significant strengthening of public finances, the planned restructuring of the financial system, including the privatization of the provincial banks, and the structural reforms to increase the efficiency and competitiveness of the economy under the program should ensure the viability of Argentina's currency board arrangement"[15].

However, the viability Camdessus believed in, had already experienced many obstacles, and it did not flow naturally, but required frequent adjustments, austerity policies and external

[15] Ibidem p. 12.

loans. Carrizosa, Leipziger and Shah affirm that “The financial crisis of December 1994–April 1995 demonstrated the difficulty of crisis management under a currency board system […]. Argentina’s quasi-currency board arrangement places the central bank in the difficult position of providing both limited “lender-of-last-resort” facilities and peso convertibility on demand”[16].

The central bank managed to do so (with IMF assistance), but was not capable to avoid a surge of the interest rate up to an almost intolerable level, and it was just an external intervention which made it possible to stabilize the economic situation.

Given the vulnerability to external shocks Argentina had (which lately will be deeply analyzed) it would have been a possibility to quit the currency board in the last two years of the 90’s (as Brazil did) after recovering from the Mexican crisis.

3.2. The late 90’s: the depreciation of Real

In 1997 the Brazilian government was expecting an attack to its currency (pegged with the US dollar), having already been under speculation attack the major and strongest Asian economies.

However, what made investors’ confidence to Brazilian economy weaver was Russian 1998 default. The markets supposed the impossibility for Brazil to keep its peg without any stronger devaluations. Brazilian peg was not a currency board such as the Argentinean one, in fact it was a crawling peg. This is an exchange rate adjustment technique in which the par value of a fixed exchange rate is allowed to fluctuate within a certain range of values. The par value is adjusted for inflation and other market factors. A crawling peg, differently from a currency board, allows the exchange rate to adjust over time, hence "crawl," rather than be subjected to eventual and dramatic currency devaluation, imposed by the impossibility to keep a certain rate of interest. Therefore Brazil, differently from Argentina, could use monetary policies, even though under a strict regime, giving their government an instrument more to face the imminent crisis. More, it initially managed to avoid devaluation using

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[16] www.imf.org, Finance & Development / March 1996. The Tequila Effect and Argentina’s Banking Reform, Carrizosa M., Leipziger D.M. and Shah H.

central bank reserves in foreign currency, reserves that in the years 1996-1998 dropped by $24 billion (40%)[17]. In addition to that, IMF settled a series of loan to help Brasilia defend the Real, realizing that "The sharp decline in public sector savings--only partly redressed by a recovery of private savings--was reflected in a deterioration of the external current account balance--from near equilibrium in 1994 to a deficit equivalent to 4.1 percent of GDP by 1997. This, in turn, heightened Brazil's vulnerability to external shocks and to sudden changes in market sentiment"[18]. At the end the pressure was too high and the government decided to devaluate abandoning the peg. Being Brazil the main Argentinean economic partner, the market turned their attention to Buenos Aires and its peso as the next candidate to fall. Now we shall see the response from the *"Casa Rosada"* and the reasons why it failed.

3.3. Menem's proposal: dollarization.

The scenery Argentinean president Carlos Saúl Menem faced was complicated: he could decide either to devaluate (abandoning the currency board) as Brazil did, or try to defend the peso. Using Ferro's words, "he doubled the bet" announcing he would rather dollarize than devaluate.

Menem started his negotiation with Washington proposing a 3 point dollarization program:

1) Share segniorage coming from the use of Dollar in Argentina.
2) Access of Argentine banks to the discount window of the FED.
3) Co-operation in banking surveillance.

However, the answer was negative. Briefly, "Officers of US Treasury and the FED remarked that the US will not awarded access to discount window, neither surveillance to banks in Dollarized countries, but the United States could share segniorage"[19].

In fact, dollarization could also be unilateral, since the United States could not prevent a country from adopting the US dollar as its official currency. "To replace the currency, Argentina needs to take the liquid reserves that currently back the monetary base, sell them

[17] www.eiu.com.The Economist Intelligence Unit. The Economist.
[18] www.imf.org, Press Release No. 98/59 December 2, 1998.
[19] Ferro G. (2001) Currency Board: From Stabilization to Full Dollarization? The Argentine Experience, UADE, Buenos Aires. P.12.

for dollars, and exchange all outstanding peso notes for dollar notes. Once that has been accomplished, the peso has been eliminated, and the only legal tender is the U.S. dollar. Then, all peso-denominated deposits,
debts, securities, and contracts are relabeled and become dollar-denominated"[20].The problem in this case is represented by the renounce to segniorage, that according to Velde and Veracierto in 1998 it represented 0.2% of Argentinean GDP. More, Buenos Aires not only would have renounced to that gain but also would have had to transfer that part of GDP to FED. The reason is that to dollarize unilaterally the central bank has to eliminate the peso-denominated monetary base. Since the assets were already dollar-denominated (because of the CBA) it had to convert just the currency in circulation. The problem is that monetary base growth is not equal to zero but positive, usually with "roughly the same rate as nominal output" (Velde F. and Veracierto M. 2000) . This meaning that Argentina would have literally had to buy dollars from the US to use them as a currency. That is why Menem tried to negotiate with Washington for a bilateral agreement. He could not conclude his negotiation before the end of his second term (the maximum for Argentinean constitutional law). Moreover his party, the peronists, lost the elections fronting the social democratic De La Rua. The new administration, "along with US Treasury secretary Lawrence Sumners, took a position against dollarization"[21].

Surely we cannot be sure if dollarization would have been positive for Argentina, however we can make some remarks to this striking hypothesis, for the first time a wide, important country fully dollarized (until that moment Panama was the only no city-state dollarized country).

For sure, full dollarization would increase the credibility advantages of the currency board, since markets would not fear the possibility for the Argentinean government to rapidly abandon the peg and devaluate. The executive power in Argentina had the power to do so by decree, with the requirement of approval by the bicameral congress just in a second time. Not printing his own currency could give a further advantage countering the default

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[20] Velde F. and Veracierto M. (2000), Dollarization in Argentina, Issue paper, The federal reserve bank of Chicago. P.28.

[21] www.colorado.edu, Economic and Political Change in Argentina, Argentine projection page.

possibility, “Since dollarization takes away the government’s ability to raise segniorage, it may be a factor in reducing country risk”[22].

The other side of the coin is commonly considered to be the impossibility to act as a lender of last resort for the central bank. However, the currency board would also not allow this, and Velda and Veracierto greatly explain the means used by the government (passed after the tequila crisis) to ensure liquidity to banks in trouble.

In my opinion, the impossibility to dispose of the monetary policy might have been the greater problem. Also under currency board monetary politic is blocked, even if there is the chance to abandon the peg in a period of crisis. Switching to the original currency after dollarizing has really high costs, thing that give even more credibility, the markets believing impossible the exchange rate regime to change. The costs of reintroducing the national currency are:

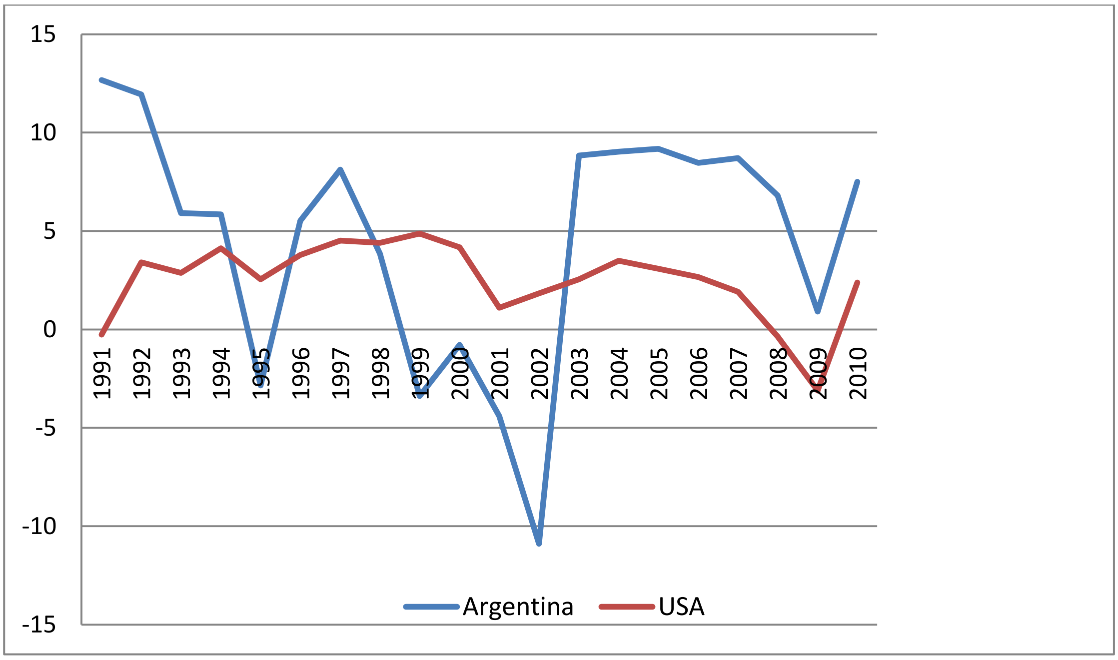
- Time costs: physically replace the currency in circulation.
- Reserve costs: going back to the national currency means an impossibility to sustain dollarization. This would cause a drop in credibility and a devaluation of the national currency. The banks’ reserve assets would have been all dollar-denominated so the value of the reserves would have dropped.
- because of devaluation (followed by inflation) people probably would decide not to change their cash dollars into the national currency because dollars do not sensibly devalue, keeping aside dollar cash reserves. Consequently the central bank should print money to restore the currency in circulation, increasing inflation more than proportionally with regards to devaluation.

At first glance dollarization could have been a positive solution, especially considering that Argentinean monetary policies have been worsening in time, but the problem is the asymmetry between US and Argentinean economies. Not only the vulnerability to external shocks, clearly different, but also the different degree of the openness to capital flows. Concerning the first point, the question is: are Argentina and the United States subjected to

[22] Velde F. and Veracierto M. (2000), Dollarization in Argentina, Issue paper, The federal reserve bank of Chicago. P 31.

the same growth cycles? If not dollarization would be problematic since Washington monetary policies would be in contrast with Argentinean needs. Analyzing the period 1991-2010 (graph 3), it is clear how US path is pretty constant - with the exception of the 2008-2009 crisis – while the Argentinean one is made out of hikes and drops. In addition to that, there are three intervals when the two countries do not have a positive growth: 1995, 1999-2002 and 2008-2009. We will not take into consideration the second one because of the crisis: arguing either or not dollarization would have been positive in that period, 2000-2002 is not valuable to understand the regular path of the two economies. More interesting are the years 2008-2009 and 1995.

Graph. 3. GDP growth (annual percentage) in Argentina and Us from 1991 to 2010.



source: independent elaboration. Data from “World DataBank”, databank.worldbank.org.

The Us fell into recession in the period 2008-2009, starting point of the recent crisis which spread to the Euro zone becoming internationally relevant. Argentina at the same time was following a different course, being 2008-2009 years of growth (even though the % rate decreases in both countries, in Argentina stays positive and the country does experience a recession). Also during the tequila crisis (1995), while Argentina had an approximate negative growth of -2.84%, US were not sensibly affected by the Mexican recession, even though The United States represent for Mexico the most important commercial partner.

This examples show how the United States and Argentina are not sensible to the same shocks, highlighting an absence of symmetry among the two economies.
In this situation we could not be sure of a correct functioning of a dollarization system, presenting the analyzed case both positive and negative aspects.

3.4. The excessive vulnerability to external shocks.

Our dissertation brings us to say that the main cause of the crisis was Argentina's trend to be too much volatile. A normal circumstance for a developing country, extreme in the studied case.
In this paragraph we are going to explain the reasons of such a destabilizing economic condition in the 90's in Argentina.
Summarizing, two are the explanation to the country's vulnerability[23]:

1) The country got in and out the international credit market. In determined periods, when the spread arose over a certain threshold (10%), kept itself out of it. Only when the spread was going down decided to reappear on the market.
2) Fiscal problems. Deficit to finance and short period credit to refinance (urgent deadlines). The country fell in a vicious circle: making more debt to pay imminent debts. The result was a hike of interest rates (and the spread).

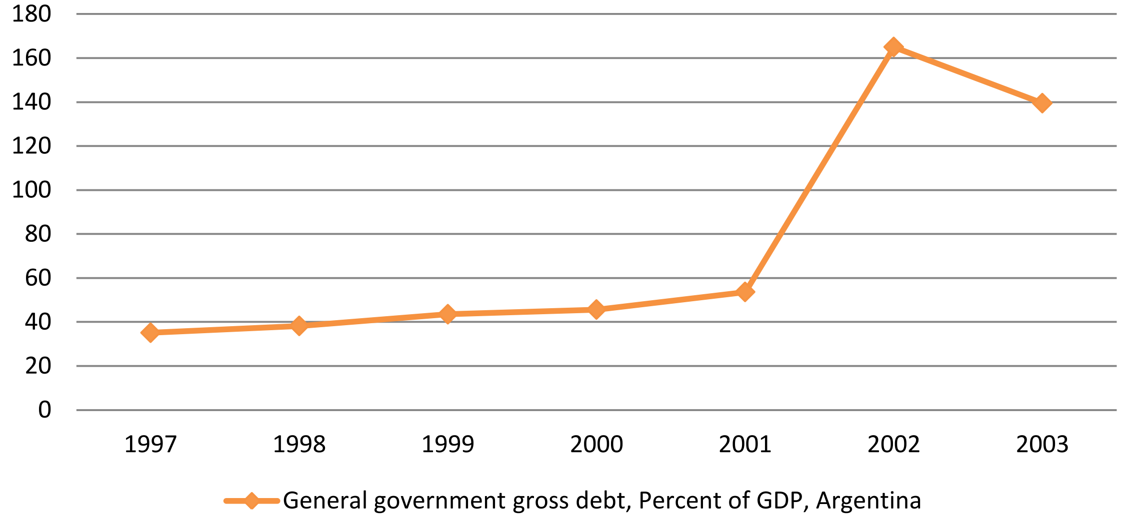
Argentinean integration with international economy is quite problematic and present a couple of asymmetries. "First, while the economy's degree of openness is very low when measured on the basis of trade, its openness to capital flows is much higher. Second, trade flows between Argentina and the US are very low but the bulk of Argentina's external debt is denominated in dollars and domestic financial intermediation is largely dollarized. An additional asymmetry and possible source of instability is that the public sector is heavily indebted, while the private sector holds substantial amounts of foreign assets" (Fanelli 2003).
In addition to that, country's fiscal problems were increased by the pre-election policies of 1998-1999. Common is that following political business cycles, public debt increases during the pre-election period and Argentina did not avoid this recurring phenomena. In case of an

[23] Ferro G. (2012), private interview.

opportunistic model there will be an expansion of the public sector of the economy to promote the reelection of the current president or leading party.

As said in point 2, the country had already fiscal problems to face, and these further expenses made it impossible to finance deficit to counterbalance the downturn of 1999. As graph 4 shows, from 2001 to 2002 Argentinean public debt went up drastically since the government was producing debt to pay its short period obligations. Therefore it resulted impossible for De La Rua's administration to use public resources to finance welfare programs, allowing an economic strategy similar to Roosevelt's New Deal.

Graph 4. source: indipendent elaboration, data from International Monetary Fund, World Economic Outlook



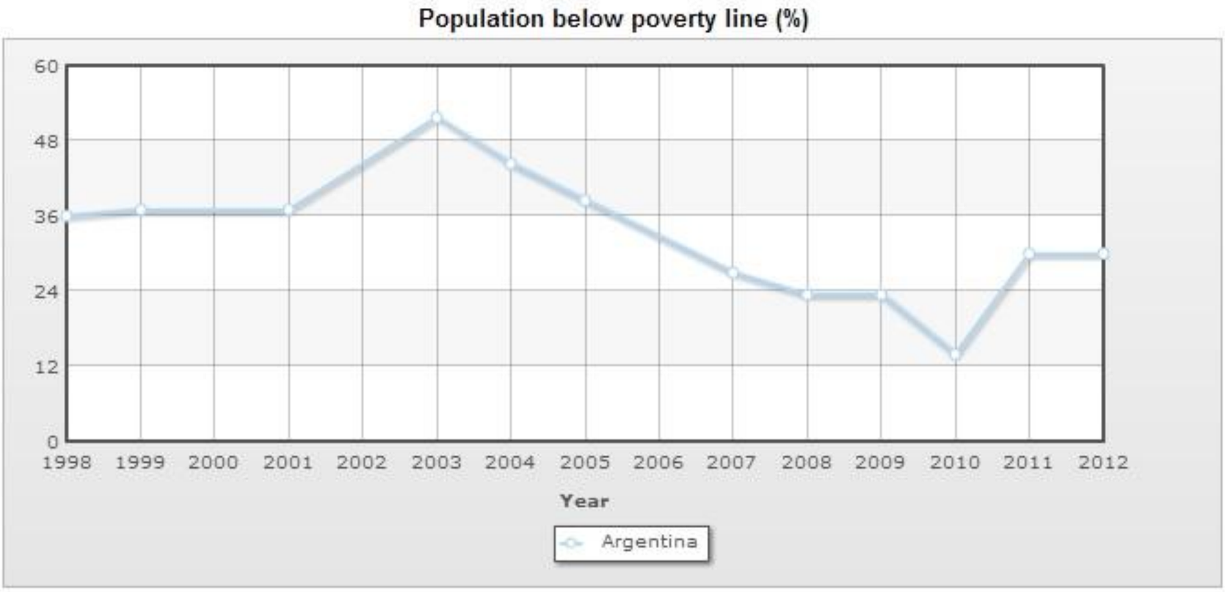
We shall see in the next paragraph which policies De La Rua (new elected president in 1999) opted for to face the crisis. The macroeconomic situation he had to face was extremely complicated since Argentina's vulnerability to external shocks made ineffective the currency board.

In spite of the peg with the US dollar, the interest rate rose up to an amazing pick (around 60% at the end of 2001-graph 4) forcing the country to devaluate and abandon the currency board shortly after. However the attempt to maintain it had terrible consequences on the real sector of the economy falling GDP and increasing unemployment (graph 1 and 2). Population below poverty line was 37% in 2001, around 45% in 2002 (graph 5). There were several assaults to shops and supermarkets to satisfy basic needs. People started a series of strikes, one of the most important July 19, 2001, against De La Rua's administration. "In a number of cities, workers blockaded highways, while in Buenos Aires, workers and students demonstrated outside the stock exchange until riot police backed by a water cannon dispersed them. Aereolineas Argentinas, the national airlines, was shut down entirely by the walkout, as were trains, bus service and urban transport. An estimated 60 percent of the industrial sector was paralyzed"[24]. The country was paralyzed. Now we will see how it got there.

Graph 5.

Graph 6. Source: indexmundi.com

[24] www.wsws.org, Argentine workers strike against austerity measures, Vann B. (2001).



3.5. 1999-2001: De La Rua’s attempt to stop the crisis.

Fernando De La Rua tried to stop the crisis with an austerity policy, with the aim to increase market’s trust to Argentina. He approved two laws “la Ley de Responsabilidad Fiscal” (Fiscal Responsibility law) at the end of 1999 and later on “la Ley de Defict Zero”. The first one consisted in a tax rise and a series of cuts of public expenditures. The goal was to decrease the general government debt to the “zero line” in a couple of years. The second one was approved to stabilize government short period balance, adapting expenses to incomes. However it granted some categories of expenditures such as interests payments and retirement funds coverage (below 500 pesos, 500 dollars at that time). To achieve the aim, there was a cut of 13% on all not-protected categories of public expenditures, especially on retirement funds superior than 500 pesos. Flanking these fiscal measures, recalled economy ministry Cavallo took some financial initiatives to fully restore markets’ confidence in Argentina. Cavallo was the promoter of the currency board at the beginning of the 90’s and the author of the miraculous growth of the beginning of the decade. De La Rua called him in the first half of 2001 to substitute Ricardo Lopez Murphy, whose policy was not getting along with the president one . Cavallo tried to defend his creature (the currency board) with stubbornness. First “He fiddled with tariffs and, fatally, with the currency board itself, so that the peso was pegged for exporters half to the dollar, half to the euro. This was, in itself, a good idea, but the timing was disastrous. By raising the idea of devaluation, it spooked foreign investors. They demanded a higher risk premium for holding Argentine bonds, driving up interest rates and deepening the recession"[25] (graph. 7). Then he played with the banking system, braking that security system developed during Menem's legislation in the years that followed the tequila crisis. The analysis of the economist proceeds: " Not only did he oust Pedro Pou, the Central Bank's governor, and ease banks' reserve requirements, but he raided the financial system to pay for the government. When foreigners jibbed at Argentine bonds, rather than declare a debt default and/or devalue, Mr Cavallo sought money elsewhere. He strong-armed local pension funds into buying government paper and local banks into swapping their holdings of government bonds in return for low-interest loans"[26] (the so called "canje"). These last resort measures did not help restoring neither international nor internal credibility.

Graph. 7

Fear of insolvency spread among people with the result of a run on deposits. Between July and November 2001 "Argentines withdrew some $15 billion from the banks"[27]. The measure adopted to protect banks' reserves was the famous "corralito" (small enclosure). It was a law which freezed banks' deposits, limiting to $(pesos) 1,000 a month the possibility to withdraw. After 12 months of riots, demonstrations and strikes, December 2, 2002 the corralito was suspended. The country had to restart its growth path and people wanted their money devolution. The issue was represented by the exchange rate imposed after the repeal of convertibility law (currency board) by president Duhalde (January 2002) with a provisional law which fixed the change at 1.4 pesos per dollar. However, when the deposits were freed the quotation was approximately of 3.60 pesos per dollar, meaning that the real purchasing power of an Argentinean citizen lowered than more than a half. For instance, "Un

[25] www.economist.com, A decline without parallel, Feb 28th 2002, Buenos Aires.
[26] Ibidem current page.
[27] Ibidem current page.

depositante que tuviera US$10 mil pasó a tener 14 mil pesos, cuando a los precios actuales debería recibir alrededor de 36 mil pesos"[28] (One who was titular of a deposit of US $ 10 thousand got 14 thousand pesos, when at the current prices should have received 36 thousand pesos). Anyhow, the country managed to recover, economy restarted growing despite the "fade" of both private and public reserves.

[28] http://news.bbc.co.uk

4.
Concluding Remarks.

The Argentine case is very famous and studied in the recent literature because it set an unpredictable precedent. No one could think that a huge country with a GDP (based on purchasing-power-parity (PPP)) of 330,722 billion dollars in 2001[29] could fall into a default. Nowadays the markets may take into account the possibility that a country can actually go bankrupt and this idea is really to be fear by countries with government debt troubles. Being possible the bankruptcy markets will be much more demanding then before the 2001 situation increasing the country risk even more than how it would actually be. In the modern globalized economy the possibility of a default might be the real cause of the default. Credibility and communication are key elements in the modern administration of a country. It is impossible to set economic policies just basing on numbers and trends. It is not enough. Robert Lucas in 1976 was the first one to theorize the importance of microeconomics and expectations in the formulation of a macroeconomic model. Lucas was a pioneer in this field because never like in this age information spread rapidly and behaviors can be influenced in few days, if not seconds. Not just the media but also the net is responsible of an uncontrolled spillover of information (through or false it is not important) crucial in shaping people's mind. That means that expectations are even more important now respect to Lucas' times. Said that, the government has two administration options: the first one is trying to control and modify people's expectations in order to take the policies that better fit with the macroeconomic models. If it fails in this attempt, its policies have to go along with the expectations, unless the governments is ready to bear a heavy decrease in the real sector of the economy and the social tensions that would follow. We saw in Argentina where the "corrallito" brought and also Athens in more recent times experienced the results of unpopular measures. Measures that usually political government do not like to take since they would probably mean a negative result in the elections. That is why unpopular measures are often taken by technical governments. Still, both political and technical

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[29] International Monetary Fund, World Economic Outlook Database, October 2012

government should always have in mind the real sector of the economy before adopting certain policies, because it is the real economy the engine of a country.

Regarding to the Argentine case, apart from the importance of expectations, it might be interesting to do another consideration. Are the economic tools used during the decade 1991-2001 generally inefficient, or they were not well managed? The analysis we made on the currency board partially answers to this question. We saw that other currency board worldwide worked and they did not lead the countries which adopt it to a default. In addition to that, Menem's will to align with the liberal principles of the Washington Consensus changed drastically the way of making economy in the country. A country that was traditionally socialist and the state aid was a very important pillar. A country where bureaucracy was slow and inefficient. A country where corruption was not the exception. In this kind of situation the change cannot be revolutionary, but gradual as Popper thought. The policies and the economic tools used by the administrators appropriate to the culture and to the informal structures present in the environment.

With regards to this concept, interesting is Khan (2008) analysis. He focuses on the sustainability of political-economical reforms defining two different kinds of governance: growth-enhancing and market-enhancing. The latter is the one focused on the utilization of econometric models to fix market failures. It is based on the idea that an efficient market is the answer to development. Who sustains the market-enhancing governance believes that the creation of an efficient market ensures further development and growth both in developed and developing countries. Khan does not agree with theory, introducing the concept of growth-enhancing government not as an alternative to the market-enhancing one, but as an inevitable flanker. Indeed an efficient market allows growth just in already developed states, while other kind of policies must support the market in developing states. In the 80's the liberals found this impossible since they believed that growth-enhancing policies corresponded exactly to aid policies, then in contraposition to the liberal theory. As we saw with our study case, macroeconomic tools had not been enough to promote a growth path, on the contrary tools that have worked in other countries lead Argentina to default.

What Khan suggests, then, is that to make an efficient market effective in terms of growth, the governance has to focus its policies on three major aspects typical of developing countries:

- Weak property rights and the prevalence of non-market asset transfers;
- Catching up, technology acquisition and governance capabilities;
- Governance and the management of political stability.

The first issue is very common in developing country representing an obstacle to growth. The uncertainty of property discourages investors because of high transactional costs. For instance, if a company would like to buy a huge piece of land subdivided in many lots in order to build a factory, knowing to whom each lot belongs is vital for the conclusion of the trade. The problem is that in places were culturally property is not "put on paper" this kind of transaction becomes quite impossible, the company being charged of the cost of investigation, other than the loss in time. The property right issue, however, goes beyond uncertainty. The risk is also that people's property right might not be ensured, because of a lack of protection or due to political reasons. Political instability is a factor in the changing policies on property rights. For example after a switch from a liberal to a socialist regime, it is possible that peasants are allowed to occupy the legitimate owner's land, or also in a democratic regime, the new political line is to dispossess and nationalize all the main enterprises of the country like in Argentina in the decade 2002-20012 under Nestor Kirchner and his successor Cristina Fernandez. A private has no incentives in investing in this kind of environment. Ensuring property rights is a priority for a growth-enhancing governance.
The second aspect concerns the acquisition of technology, seen as an element of primary importance to ensure growth. The most efficient market is not capable of attracting high-tech investments in a not developed system. Very easily, it would be impossible to sell smart phones were an internet Wi-Fi connection coverage is not guaranteed. Without the internet it would not be capitalized the whole potential of the device, so nobody would pay for it. Technological catching up needs great investments and most of them are very close to be public goods (better: tool goods, not rival but excludable) like the internet, infrastructure such us ports, airports, railways, also education, to make some examples. Privates do not find it profitable to invest in this sectors because of the high costs and the free riding

possibility. The government has the responsibility to "pull the spring", starting the technological growth process being able to involve the private sector in the following step of investments.

The last issue involves two different aspects: corruption and patron-client policies. Both are cultural based and very hard to fight. In Latin countries corruption is the rule, not the exception. It might requires more than a generation to partially solve the problem with a massive investment in education. Also enforcing police controls and the certainty of a penalty could be effective policies in the short period. Unfortunately a common justification heard about corruption is the following: "don't worry about it, everybody does it". The fact that being corrupted is the praxis gives the allowance to be corrupted. Fighting an idea, a mind status, is much more difficult than applying an econometric model, I believe.

In synthesis, a market, also an efficient market, can be effective in developing countries, such as Argentina, just if these three aspects are regulated. Therefore a wise government has to pursue to different parallel paths: fixing market failures, solving cultural and technological problems.

Also Williamson in his 2004 work[30], commenting on his previous paper, the quoted one about the Washington Consensus, affirmed that in developing countries there is the necessity of a "social revolution" before any kind of economic reforms. He says that "The solution is not to abolish the market economy, which was tried in the communist countries for 70 years and proved a disastrous dead end, but to give the poor access to assets that will enable them to make and sell things that others will pay to buy". His new agenda for developing countries' governments is similar to khan's one, including:

- Education (human capital improvement);
- Titling programs (providing property rights);
- Land reform.

To the upper set of three, he adds Yunus' idea of Microcredit (1999). Briefly, microcredit, started by Yunus with the Grameen bank in Bangladesh, is a financing system for the poor. It allows them to start little activities, buying and selling assets, thanks to micro-financing

[30] Williamson J. (2004) A Short History of the Washington Consensus, Paper commissioned by Fundación CIDOB for a conference "From the Washington Consensus towards a new Global Governance," Barcelona, September 24–25, 2004. P. 13.

contracts (of even US $100) at minimum interest rate, without any guarantee requests. Yunus wrote in his book that most of the loans are paid back thanks to the way of working in little communities (social control and personal gratitude) and to the strategy of giving part of the money to the applicant in the form of bank quotes, feeling the debtors in debt with themselves, other than more involved in the system.

In conclusion, solving social issues, like corruption, mass education, access to credit for the lower classes, is a key element to enable a boost in the economy.

Finally, Argentina teaches us that it is not profitable to import a given model into a country with very different characteristics.

There are not correct economic models, just economic models. The difficulty for a government is to find the one the better fit to its population, in order to ensure that population the best lifestyle it can have.

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