1 Introduction

During most of the 1990s, Argentina enjoyed stability and an economic boom such that many Argentines felt that their country had entered the path of catching up with the industrialised countries, and so would finally approach its deserved place in the world. Indeed, the first world was where the country arguably once belonged to: barely a century ago, Argentina, the land of silver\textsuperscript{1}, ranked among the richest nations in the world: its income per head was on a par with that of Germany and France in 1913\textsuperscript{2}. This wealth had been achieved through a textbook process of catching up via productivity-enhancing technological progress, financed largely by foreign investment, in the global free-trade environment of the late 19\textsuperscript{th} and early 20\textsuperscript{th} century\textsuperscript{3}: both the new technology of deep freezing and the extensive construction of railways connecting the remote Pampa areas with the Atlantic coast had enabled the country to export its main staples, beef and other agricultural products, on a large scale to Europe. Present-day Buenos Aires, the "Paris of the South", is still, in its grandeur, witness of these golden years, which attracted masses of immigrants\textsuperscript{4}.

Entering the 21\textsuperscript{st} century, the second-largest South American country with its well-educated population of mainly European descent and its abundance in natural resources has found itself brutally disillusioned. The tragic crisis the country experienced in 2001/02 put not only an end to the expectations of catching up fast but also added the worst recession in the country’s history and another bad political turmoil to the series of crises and chronic instability that mark the country’s history since the 1930s.

The growth of the 1990s was the result of successful stabilisation via the "Plan Convertibilidad", a currency board arrangement cum escorting economic policies, with the fixed Dollar exchange rate at its core. The currency board’s success in putting an end to the previous decades of ever higher inflation, and finally

\textsuperscript{1} Argentina’s name is derived from "argentum", Latin for silver, due to its erstwhile important silver mines on the territories of present-day Bolivia, the exploits of which were shipped through the port of Buenos Aires.

\textsuperscript{2} See N.N. (2004), p. 4.

\textsuperscript{3} See the seminal paper "Catching Up, Forging Ahead, and Falling Behind" written by Moses Abramovitz in 1986.

\textsuperscript{4} "Etre riche comme un Argentin": this French idiom of the time is further witness of the country’s former splendour.
hyperinflation, was nothing less than spectacular. Today, the judgements about “Convertibilidad”, seemingly the magic cure of the 1990s, range from “outright poison”\(^5\) to “flagrantly wrongly administered, but potentially beneficial remedy”. The Argentine currency board, its justification, its conditionalities, the reasons for its collapse, and finally its evaluation is what this treatise is about.

A thorough analysis of Argentina’s currency board requires the detailed identification of the historical, economic, and social context of its implementation, and this not only for the sake of episodical completeness but, above all, for the understanding of the determinants of its choice and configuration. Following this introduction, section 2 will therefore analyze the country’s desperate situation, marked by economic decay and high inflation culminating in hyperinflation, at the time when the new government of Carlos Menem took over in mid-1989. The complex and devastating interdependencies of causes and effects that fuel the accelerating inflationary process and lead to a continuing economic erosion over decades, and finally develop into hyperinflation, are analyzed for typical high inflations in general, and examined for the case of Argentina during the 1980s in particular. From this exercise it will get palpable that, having seen so many failed stabilisation attempts before, with the result of ever more eroded policy credibility, the country’s remaining options for stabilisation in effect excluded all but the strictest ones.

Section 3 gives a detailed exposition of the theory of currency boards. The currency board idea, its historical roots, its functioning principles, strengths and weaknesses, and the conditionalities a currency board entails with respect to its appropriateness, as well as its duration and termination, will be dealt with in detail. While the informed reader primarily interested in the Argentine case may well skip this section, for any other reader the exercise may well be worth the effort since, all too often, much is said about the dangers of the regime and little about its potentials. This is especially true for the appealing idea of dual currency boards outlined at the end of this section.

Section 4 focuses on the Argentine currency board’s implementation and development during the barely 11 years of its existence. Clearly, the two vivid growth phases before and after 1995 were owed to the market oriented reforms embraced with the Convertibility Plan, but also to favourable external conditions, just as the deep recession that started in 1998 was not solely the consequence of

\(^5\) See, e.g., Porzecanski (2003).
negative external shocks but also, and fatally, of inconsistencies between the macroeconomic framework set by the currency board and the concomitant fiscal, but also microeconomic policies. The interactions between these inconsistencies, on the one hand, and the exogenous factors aggravating them, on the other, make an exciting plot in a story that was long thought to be one of success but instead ended as a tragedy. In exploring the plot's determinants, the ground is prepared for the evaluation to follow.

Section 5 summons the main suspects to closer investigation. The spectrum ranges from the country's mainly internal responsibilities, such as fiscal lenience, the overvalued exchange rate, institutional deficiencies in labour markets as well as the industrial and financial sectors, political economy, and, of course, the currency board itself, to the multiple external conditionalities such as the behaviour of international capital markets, policy constellations within MERCOSUR, the IMF's involvement, as well as the economic credo that stood behind the country's economic course of the 1990s (the "Washington Consensus"). This allows for the extraction of the few main factors responsible, as supported by empirical evidence, for the traumatic collapse of Argentina's currency board, which, as will be argued, could have been avoided until early 2001. Though necessarily dotted with a degree of speculation, some inferences are made about potential exit opportunities during different periods of the currency board's existence. They make it seem highly plausible that any of these opportunities, if seized, would have had an outcome entailing less immediate damage than the one actually undergone.

Concluding this investigation will require some lessons to be drawn. The lessons from the Argentine experience are related to the old and central issues of risks specific to hard pegs, of sustainable fiscal policies, and of the importance of these issues increasing with global financial integration. These lessons are hardly new, but, sadly, they seem to need ever new accentuation "by default" to be paid heed to. A concluding assessment of the Argentine currency board experience, from an economist's point of view, will be undertaken. To be sure, political scientists, sociologists, or even psychologists will have additional clues to help explain this recent chapter in Argentina's history, which fits so well into the overall self-perception of many Argentines, and is prone to be interpreted as just another reflex of a tragic socio-economic dynamism. Unfortunately, the post-collapse

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6 See e.g. the popular volume of Jorge Lanata (2004).
developments, despite the fast economic recovery they included, do little so far to prove such fatalism wrong.