Conclusion

This treatise has focussed on this latest Argentine experience of exchange rate based stabilisation. To that end, it has explored the characteristics and dynamics of high inflations in general, and analyzed their manifestation in Argentina during the 1980s, the country’s so-called "lost decade". After several failed stabilisation attempts and two bouts of hyperinflation, the currency board arrangement by which the government legally tied the domestic currency to the US-Dollar provided a consequential and highly effective stabilisation tool, which arguably was, short of official dollarisation, the only stabilisation option left. For the sake of foundation and complete understanding of the functioning of a currency board, the theory of currency boards has been expounded. The importance of complying macroeconomic, especially fiscal, as well as microeconomic policies accompanying a currency board has been deducted. Given the absence of the devaluation option as well as the restricted lender of last resort capacity, the dangers arising from irresponsible fiscal policies, on the one hand, and from external shocks, on the other, have become evident.

The analysis of the Argentine CBA’s configuration has yielded its assessment as an institutionally highly credible, though in various aspects unorthodox CBA, which however, given the country’s structural and trade characteristics, could not be considered an optimal long-term solution. The depiction of the economic reforms accompanying the “Plan Convertibilidad” has hinted at some of them staying badly insufficient and putting the CBA’s sustainability at risk. Argentina’s economic performance during the 1990s has been depicted with its spectacular stabilisation boom of the early 90s, the momentous Tequila crisis, the second expansionary phase, the deep recession activated by the series of external shocks of the late 90s, and the country’s economic, political and social implosion accompanied by public default and the collapse of the CBA at the turn of the year 2001/02.

The analysis of the causes of the CBA’s tragic collapse has yielded a complex picture of interacting factors, among them invaliding factors that had created multiple vulnerabilities over years, and triggering factors that unfolded their worst potential in meeting such vulnerable conditions. Chronic fiscal imbalances have been shown to stand at the centre of these vulnerabilities, having developed into a debt load unsustainable under other than very favourable conditions, and being responsible for much of the Peso’s overvaluation. Among the various insufficient institutional reforms, accordingly, those stand out that failed to improve the fiscal
performance, led by the unsatisfactory tax reforms and, above all, the still untackled federal fiscal relations with their highly perverse fiscal outcomes. Less immediately obvious, differential monetary policies within MERCOSUR, even before Brazil’s devaluation in early 1999, have been shown to have undermined both countries’ fixed exchange rate regimes, and to vastly increase Argentina’s exposedness to external shocks. It has been argued that labour market rigidities, though eased too little and adding to the country’s deeper vulnerabilities, often tend to be overemphasised in their responsibility for the crisis, while other institutional inadequacies, such as unsatisfactory industrial and privatisation policies as well as a lack of concern for education and social policies contributed as least as much to Argentina’s lack of institutional insurance against adverse shocks. So, when the capital stop in the wake of the late 90s’ emerging economies’ crises, helped by the trade effects of Brazil’s devaluation and the appreciating Dollar, hit Argentina, these vulnerabilities were unmasked, and the ensuing recession threatened to render public and private debt and/or the fixed exchange rate unsustainable – as held by the Sudden Stop thesis which condenses Argentina’s vulnerabilities to its closedness, its indebtedness, and the currency mismatches in the balance sheets of much of its economy. It has been argued that, while default and devaluation could have been avoided through determined action, plausibly as late as in early 2001, politics proved unable to bring forward such action, and instead provided the ultimate triggers with some grave mistakes. Against these home-made blunders, reproaches directed towards the IMF or towards the “Washington Consensus”, though in certain respects justified, are bound to pale. The contemplation of missed opportunities, i.e. of options for a less costly exit from the CBA, has yielded the sobering conclusion that almost any of these options would have been preferable to the exit actually undergone in early 2002.

Some Lessons

The case of Argentina corroborates some important lessons. The first is about the dangers inherent in any exchange rate based stabilisation, and especially in a CBA: though more efficient than disinflation strategies that rely on a lengthy build-up of monetary credibility, in delivering credibility quickly and thus facilitating stable growth earlier, pegged exchange rates bear the potential of making themselves vulnerable by encouraging foreign indebtedness, currency mismatches, and overvaluation. Hence the wisdom that, if a CBA is adopted, it should remain a temporary arrangement, either aiming at an exit as early and “soft” as possible
towards more exchange rate and thus policy flexibility, or else giving way to the utmost commitment in the shape of a monetary union or its unilateral variant of complete dollarisation. In failing to do either, an economy risks to buy stability against probable future instability. The more far-reaching implication of this wisdom, and of Argentina’s and other countries’ experiences with more or less hard pegs (and a CBA contains, though it is often lumped together with official dollarisation, still only a peg to a stable currency, not a stable currency itself) is that the secular tendency of global exchange rate regimes “hollowing in the middle” (i.e. moving ever more towards the speculation proof corner solutions of either freely floating or definitely fixed exchange rates in the form of monetary unions or official dollarisation) is likely to intensify with increasing global financial integration. The Argentine experience also substantiates the finding that, beyond the immediate stabilisation needs of extremely eroded high inflation economies, the choice of exchange rate is of second order importance to the development of good fiscal, financial, and monetary institutions in producing macroeconomic success in emerging market countries.

Thus, the second lesson from Argentina concerns the towering importance of a sustainable fiscal stance for emerging economies increasingly integrated in world financial markets, or, in other words, the necessity to run fiscal surpluses during upswings to potentialise non-debt financed countercyclical fiscal policies. The importance of sound fiscal policies is increasing with the rigour of the chosen exchange rate regime, i.e. with the distance from the option to devalue, reaching its extreme for a country forming part of a monetary union or being officially dollarised. The importance of lower overall debt levels is paramount for closed economies suffering from “original sin”, i.e. unable to place local currency debt on international capital markets. Currency mismatches in fiscal and/or corporate balance sheets create a huge leverage to crisis when a real depreciation revalues debt in real terms. They are a recipe for disaster in case of devaluation.

Several other aspects add to the indispensability of a solid fiscal stance. For one, high indebtedness risks to exert at some point a pernicious influence on a country’s liquidity position, so that a vicious circle develops which emanates from

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685 Empirically, intermediate exchange rate regimes have recorded more crises than extreme regimes. See Eichengreen (2001b).
higher perceived credit risk reducing the maturities of new debt granted and which, with the deteriorating maturity structure, fires back on higher credit risk again. This vicious circle can only be avoided when a sustainable fiscal stance keeps credit risk sufficiently low so as to allow for the maintenance of a crisis proof maturity structure. In-crisis debt restructurings that trade short-term relief against higher future interest and capital payments only risk undermining the hoped-for medium-term recovery and offer no fundamental improvement.

The need for low public indebtedness receives further emphasis by the fact that fiscal consolidation under stress, i.e. in the midst of recession, is a precarious task to undertake. Although expansionary fiscal consolidation must not be an oxymoron but, on the contrary, the correction of a perceived unsustainable fiscal situation may bring down interest rates and increase demand (possibly helped by the Ricardian equivalence in reverse, i.e. by freeing demand from the suppressing expectations of higher future tax burdens), engineering such expansionary restriction is highly tricky. It depends on several preconditions, among them the reliance on expenditure cuts rather than on tax increases (which Argentina got wrong during Tequila and again with the "impuestazo" in 2000, and which it got right too late, with the "déficit cero" plan in mid-2001), and a strong political backing and high confidence in the maintenance of the fiscal slimming process. Obviously, Argentina was unable to bring forth these requirements, of which, as has been argued, political factors were certainly more damaging than the rigid currency board framework per se: first, the lack of unanimity in tackling the fiscal malaise, and second, political meddling with the own commitments proved a mixture that stabbed the last chance of consolidation.

Moreover, the case of Argentina emphasises the importance of emerging economies' efforts to increase their openness to trade, i.e. to increase their share of exports relative to domestic absorption. When the latter is financed mostly from export revenues rather than from capital imports, the size of real exchange rate swings after a sudden stop is reduced. A higher share of tradables in output also reduces currency mismatches in private sector balance sheets, and so reduces the banking sector's exposedness to real exchange rate swings, thus limiting the probability and extent of necessary financial sector bailouts. The encouragement of FDI, the privatisation and streamlining of public enterprises and banks, and industrial policies aiming at increasing international competitiveness are still, and

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687 See Eichengreen (2001a), pp. 17f.
increasingly, desirable policies for any emerging economy. An important legacy of the late emerging markets’ crises is that ideological blinders against capital controls aiming at reducing short-term capital inflows, and even against the idea of taxing foreign exchange transactions (the Tobin tax\(^{688}\)), have been widely put off, and reducing speculative inflows has become a presentable endeavour.

Further lessons have to be drawn from the international financial institutions’ experience with Argentina. Chronically torn between the options of either leaving a country’s solvency problems to the markets (including leaving a big emerging market debtor to default, risking contagion, and endangering the global economy) or bailing it out (and thus fuelling moral hazard by letting capital markets collect risk premia without bearing the risk), the IMF hoped to be able to minimise the drawbacks of both options with the catalytic approach, which turned out to have failed in Argentina. The need for new approaches in international finance has been articulated since the late 1990s’ crises, and several proposals have been made. One of them is the idea of a “sovereign Chapter 11”, i.e. an internationally acknowledged standard sovereign bankruptcy procedure including the installation of a bankruptcy court for sovereign debtors that would shelter them from disruptive legal action of creditors until an orderly debt restructuring would be carved out\(^{689}\). A less ambitious, though easier to realise, approach is the adoption of collective action clauses in new bond issues so that creditors lose their right to sue individually, and the cost and duration of restructurings are reduced. Indeed, such collective action clauses are meanwhile standard in emerging-market sovereign bonds\(^{690}\). Still another idea is the Lerrick-Meltzer proposal according to which the IMF would, for a crisis government, ensure liquidity in the market for defaulted debt, in order to obtain a market conform reduction of debt to a sustainable level, and avoiding panic and contagion\(^{691}\).

\(^{688}\) See e.g. Frankel (1996), p. 156.

\(^{689}\) See e.g. Krueger (2002).

\(^{690}\) Argentina has included collective clauses in the bonds issued in the debt restructuring, as well as aggregated voting provisions which allow for amendments in key terms with the vote of a pre-defined majority of the aggregate principal amount outstanding. See Gelpern (2005), p. 6.

Argentina's New Challenge

Argentina today faces not much less of a challenge than it did 15 years ago. True, devaluation has opened a valve and removed overvaluation, and the "flexible" exchange rate (indeed, it is, at the time being, held intentionally undervalued) potentialises more degrees of, at least temporary, freedom in economic policy. But, for the long run, such freedom depends on the very same fundamental preconditions that would have been required to keep the CBA sustainable.

Although four years after the CBA's collapse, export (especially the agrarian and tourism) sectors are booming, foreign reserves are flowing in, the pre-crisis GDP level has been reached again, unemployment is half of its peak level, and public as well as current accounts are comfortably in surplus, none of the microeconomic deficiencies inherited, few of the numerous breaches of contract caused by devaluation, and little of the serious derangements added through the government's crisis management have been tackled as yet. The crisis and its aftermath would have offered a chance to renegotiate the federal fiscal redistribution mechanism, and to convert the tax system towards a higher reliance on income taxation and higher tax compliance. However, little more than some questionable patchwork has been done in both fields.

The public debt to GDP ratio is, after the restructuring of over 100 billion Dollars of debt plus interest accrued, still dangerously high at 75 percent. The financial system is only slowly recovering from paralysis. Long-term credit is still virtually non-existent. Most utility tariffs are still at their 2001 levels (while wholesale prices have risen by 80 percent since that time), covering operational costs with luck, but none of the big investments needed. With the capacity constraints increasingly felt, inflation is accelerating again: the annual inflation rate has surpassed the 10 percent mark in late 2005.

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693 "In general, it was not the exchange rate regime alone that was the fundamental source of precrisis vulnerability and of subsequent substantial damage. And changing the exchange rate regime will not automatically correct (although, [...], it may help ameliorate) these other critical problems." Mussa et al. (2000), p. 22.
694 As to the federal fiscal redistribution, provincial revenues have been merely fixed at their 2003 revenue levels.
695 "Since we didn't have money, we had to offer time." Alfonso Prat-Gay, the then central bank governor, cited after N.N. (2004), p. 10.
Monetary restriction is now the means to avoid a relapse into chronic high inflation. This means reining in monetary expansion (itself the result of the absorption of 6 billion Pesos of quasi monies, and continuously fed by incoming export revenue) and strapping growth, mostly by maintaining public, and increasing private, saving; the development of domestic capital markets is badly needed\textsuperscript{696}. A more restrictive monetary stance may be imaginable as long as the economy is comfortably growing. It is anyone’s guess where Argentine politics will turn to when the catch-up growth slows down and/or external conditions start to worsen\textsuperscript{697}.

Worryingly, Néstor Kirchner’s policies, always fickle and difficult to interpret, have moved from outwardly populist, but economically mostly orthodox and arguably sensible in many instances, to a more factual left-leaning nationalist stance. Since the October 2005 congressional elections, Kirchner has not only changed to an even more provocative rhetoric vis-à-vis the IMF, the US, and foreign investors (which he regularly blames flatly for Argentina’s crisis), but also increasingly fleshes his rhetoric with action. His sacking of the well-renowned economy minister Lavagna in November 2005 (and replacement by a low-profile crony), his demonstrative turning to the Venezuelan president with his ideas of a Bolivarian revolution re-issued, as well as his latest decree to pay back the IMF in full until the end of 2005 (yet another encroachment upon central bank independence), all bolster his demonstrative repudiation of the global economy’s functioning principles. They not only leave little reason to expect politics bringing forward the central reforms necessary to facilitate sustainable growth in the long run, but also compromise Argentina’s basic outward orientation, and further endanger its development prospects. Possible hopes attached to MERCOSUR and its potential to stimulate efficiency enhancing economic policies\textsuperscript{698} have been frustrated also by the acceptance of Venezuela as a full member, which seems to redress regional solidarity towards mainly political ends while putting economic goals on hold (at least those running deeper than cheap oil or ready government credit). These recent developments do not leave much ground for hopes that

\textsuperscript{696} See de la Torre et al. (2003), p. 27.

\textsuperscript{697} The central bank is presently changing course from the quantitative targeting policy adopted after 2001 to inflation targeting, with the actual target band set between five and eight percent. See the BCRA’s monetary programme for 2005, \texttt{<http://www.bcra.gov.ar/pdfs/polmon/ProgMonPresenta2005.pdf>}.\textsuperscript{698} See, e.g., Mussa et al. (2000), Hochreiter/Schmidt-Hebbel/Winckler (2002), or Belke/Gros (2002).
Argentina might, in the pursuit of economic sustainability, soon live up to the claim of getting the "serious country" its publicity experts want it to be. Nor does the worst expectation, a relapse into chronic high inflation, seem a completely absurd idea.