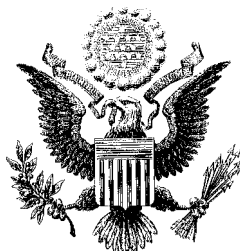


ARGENTINA'S ECONOMIC CRISIS: CAUSES AND CURES



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Summary

In 1998, Argentina entered what turned out to be a four-year depression, during which its economy shrank 28 percent. Argentina's experience has been cited as an example of the failure of free markets and fixed exchange rates, among other things. The evidence does not support those views. Rather, bad economic policies converted an ordinary recession into a depression. Three big tax increases in 2000-2001 discouraged growth, and meddling with the monetary system in mid 2001 created fear of currency devaluation. As a result, confidence in Argentina's government finances evaporated. In a series of blunders that made matters even worse, from December 2001 to early 2002, succeeding governments undermined property rights by freezing bank deposits; defaulting on the government's foreign debt in a thoughtless manner; ending the Argentine peso's longstanding link to the dollar; forcibly converting dollar deposits and loans into Argentine pesos at unfavorable rates; and voiding contracts. Achieving sustained long-term economic growth will involve re-establishing respect for property rights.

A longer background study is available on the Web site of the Vice Chairman's Office of the Joint Economic Committee.

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ARGENTINA'S ECONOMIC CRISIS: CAUSES AND CURES

In 2002, Argentina's economy suffered the culmination of an economic decline that began in late 1998. Box 1 lists some statistics of Argentina's crisis. The crisis was all the more unusual because it occurred when the rest of the world was experiencing slow growth, but not recession and certainly not depression. Understanding what happened in Argentina may help prevent or alleviate future financial crises. This report describes the recent crisis; discusses what Argentina could do to speed recovery; and examines the implications of the crisis for the "international financial architecture" and U.S. policy to improve the architecture. This paper is a summary of a full study that is available on the Web site of the Vice Chairman's Office of the Joint Economic Committee.¹

I. BACKGROUND TO THE CRISIS

Argentina's turbulent economic history. Argentina has a history of chronic economic, monetary and political problems. After achieving independence from Spain in a war that began in 1810, Argentina's provinces fought among themselves for many years, and no stable nationwide government existed until 1862. Until the late 1800s the provinces and the national government often financed budget deficits by printing money. The results were persistent inflation and low economic growth.

In the late 1800s and early 1900s, Argentina enjoyed rapid economic growth founded on rising exports of beef and wheat to Europe, made possible by the new technologies of railroads and refrigerator ships. During the 1930s, when important trading partners discriminated against Argentine exports, Argentina responded by beginning a switch to "import substitution"—a largely closed, self-sufficient economy, with high tariffs and extensive government direction. The result was low growth and frequent inflation. Inflation was typically in triple digits from 1975 onward.

Economic reforms of the 1990s. In 1989, Carlos Menem became president. After some fumbling, he adopted a free-market approach that reduced the burden of government by privatizing, deregulating, cutting some tax rates, and reforming the state. The centerpiece of Menem's policies was the Convertibility Law, which took effect on April 1, 1991.² It ended the hyperinflation by establishing a pegged exchange rate with the U.S. dollar and backed money issued by the central bank substantially with dollars. The exchange rate was initially 10,000 Argentine australes per dollar; on January 1, 1992 the peso replaced the austral at 1 peso = 10,000 australes = US\$1.³ Inflation plummeted from 2,314 percent a year in 1990 to 4 percent by 1994.

Argentina's reforms were faster and deeper than any country of the time outside the former communist bloc. Real GDP grew more than 10 percent a year in 1991 and 1992, before slowing to a more normal rate of slightly below 6 percent in 1993 and 1994.

¹ See <<http://www.house.gov/jec/new-prdt.htm>>.

² Law 23.928. The Law on Reform of the State (Law 23.696, 1989) was the other key law of the period.

³ Decree 2128/1991. The symbol "\$" is used in Argentina to signify pesos, but here signifies only dollars.

Box 1. A snapshot of the crisis (1998-2002) in statistics

- Real gross domestic product (GDP) fell 28% from peak (1998) to trough (2002).
- Argentina's currency, the peso, equal to US\$1 since April 1991, was devalued in January 2002 and depreciated to nearly 4 per dollar before partly recovering.
- Inflation, low or negative since the early 1990s, was 41% in 2002.
- Unemployment, excluding people working in emergency government relief programs, rose from 12.4% in 1998 to 18.3% in 2001 and 23.6% in 2002.
- The poverty rate rose from 25.9% in 1998 to 38.3% in 2001 and 57.5% in 2002.
- In real terms (that is, adjusted for inflation), wages fell 23.7% in 2002.

(Argentina suffered a recession in 1995 in the fallout from Mexico's crisis.) The major dark cloud of the period was that the unemployment rate rose. From 1989 to 1999, the number of jobs grew as fast as the population, but the number of people who wanted to work grew even faster. Inflexible labor laws and high taxes on formal employment, which remain in place today, made creation of new jobs in the above-ground economy slower than growth in the number of new job seekers. Some job seekers went to work in the extensive underground economy, which is more flexible but more precarious.

II. WHY AND HOW THE CRISIS OCCURRED

In 1998 Argentina entered a recession; by late 2001 the economy was in a full-blown depression. What caused Argentina's crisis?

External forces provoked a recession. The East Asian currency crisis of 1997-98 and the Russian currency crisis of August 1998 made investors in developed countries much more cautious about investing in developing countries generally. Brazil, Argentina's largest trading partner, withstood a currency crisis from August to October 1998, on the heels of the Russian crisis, but when confronted by a fresh crisis in January 1999, Brazil allowed its currency to float rather than maintaining the "crawling peg" to the dollar that had previously existed. The Brazilian *real* quickly depreciated from 1.21 per dollar to 2.18 per dollar before recovering somewhat. Brazil's economic growth fell from 3.3 percent in 1997 to 0.1 percent in 1998 and was only 0.8 percent in 1999. After years of gains, Argentine-Brazilian trade was flat in 1998 and shrank in 1999.

The January 2000 tax increase killed a budding economic recovery. In late 1999 and early 2000, the economy was showing signs of growth. In December 1999, Fernando De la Rúa succeeded Carlos Menem as president. His government promptly enacted the first of three packages of tax increases, which took effect in January 2000. Economic indicators quickly turned negative again as the tax increase killed the budding economic recovery.

The De la Rúa government thought that reducing the budget deficit would instill confidence in government finances, thereby lowering interest rates and spurring economic growth. Among the options for reducing the deficit, cutting spending was

politically quite difficult; the government doubted that cutting tax rates would spur enough growth in the short term to offset lost revenues; it thought markets would be unwilling to finance higher debt; and it did not wish to abandon the convertibility system and simply print money. That left only one option: increasing tax rates. The results were the opposite from what the government expected: tax increases reduced confidence in government finances by discouraging growth in the private sector, the source of the government's tax revenue.

New blunders in tax and monetary policy made matters worse in 2001. The return to a shrinking economy in 2000 and 2001 led to political problems. On March 18, 2001, ministers of the Frepaso political party resigned from president De la Rúa's coalition cabinet in protest over proposed cuts in spending. The resignations marked the start of the true crisis phase of Argentina's economic problems. The resignations weakened president De la Rúa's base of support in the Argentine Congress. As Figure 1 on the next page shows, the next day interest rates in Argentina moved to permanently higher levels, with further spikes during the rest of the year related to bad news about economic policy.

In response, president De la Rúa appointed Domingo Cavallo as minister of economy. Cavallo brought great prestige because of his role as economy minister from 1991 to 1996, when he had helped create the conditions for strong growth in the early years and then had a lead role in resolving a financial crisis in 1995. However, in his return as economy minister, Cavallo undertook policies much different from those he had instituted before. De la Rúa and Cavallo secured the approval of Argentina's Congress for two more packages of tax increases, in April and August 2001.⁴ The revenue each package generated was below projections.

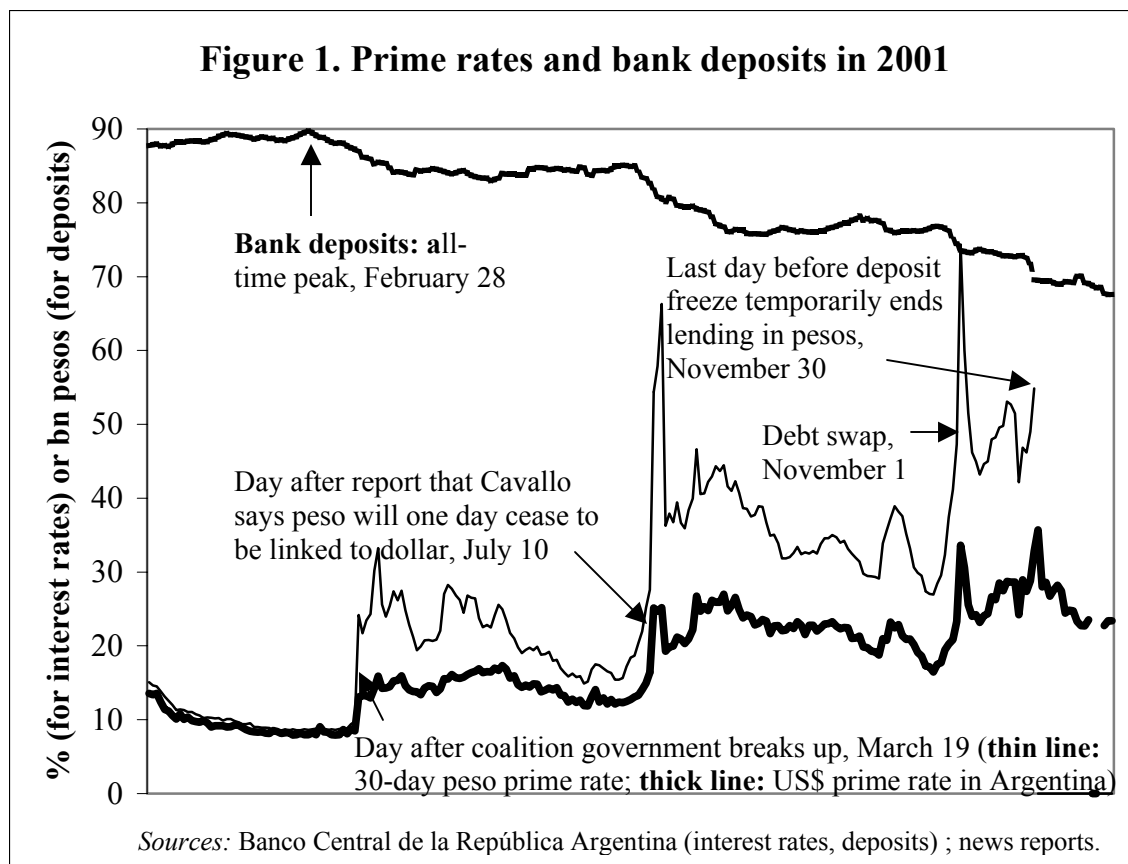
In monetary policy, the government made the key blunders in April and June 2001. On April 17, Cavallo introduced a bill to switch the exchange rate link of the peso from the U.S. dollar to a combination of the dollar and the euro.⁵ The president of the central bank, Pedro Pou, had advocated dollarization (officially replacing pesos with dollars at one-to-one) if necessary to ensure credibility for the peso. His views put him at odds with Cavallo and De la Rúa. On April 25, De la Rúa fired Pou and replaced him with a more pliable official.⁶ On June 15, Cavallo announced a preferential exchange rate for exports.⁷ The special exchange was a step back towards the interventionist practice, frequent before the convertibility system, of using government decrees for applying different exchange rates to different types of buyers or sellers by government decree, rather than allowing everyone access to the same exchange rate in a free foreign-exchange market.

⁴ Laws 25.414 and 25.443.

⁵ Law 25.445. In Argentina, the executive branch can introduce bills directly into the Congress.

⁶ Officially, Pou was fired because an investigation by the Argentine Senate found that the central bank had been lax in monitoring money laundering. Unofficially, the investigation was widely seen as being about whether the central bank would remain independent enough to keep the convertibility system unchanged when president De la Rúa wanted to change it.

⁷ Enacted by Decree 803/2001, effective June 19, 2001.



The Argentine government entered a “debt trap” by mid 2001. The new taxes further burdened an already struggling economy. The changes in monetary policy reduced confidence in the peso. Even interest rates in dollars within Argentina rose substantially, because of concern that loans and deposits in dollars were also at risk from government policies. High interest made it costly for businesses to expand using credit and contributed to the recession.

The government’s failure to take effective measures to end the recession created a crisis of confidence in government debt, because a shrinking economy meant a shrinking base of tax revenue from which to pay the debt. Argentina’s federal government had been paying anywhere from 3 to 9 percentage points more than the U.S. Treasury to borrow. After the monetary policy blunders of April 2001, the premium jumped to almost 13 percentage points. In July 2001, when rating agencies reduced the credit rating of Argentina’s government debt, it rose above 16 percentage points, and by the end of October it exceeded 20 percentage points. Such high rates indicated many investors feared a default. The government was in a “debt trap”: at the interest rates it faced for borrowing, the debt would quickly grow so fast as to exceed the capacity of the government and the Argentine economy to repay it.

Government policies “contaminated” the private sector in late 2001 and 2002. In December 2001 the crisis entered its final phase, in which the government spread its problems to the private sector through a variety of policies rather than trying to

minimize the spread. Faced with a choice of “contamination” or “quarantine” for its problems, the government chose contamination.

The difficulty the government was having in refinancing its debt led to fear that it would freeze bank deposits, as it had done in 1982 and 1989. During those freezes, the government had in effect confiscated part of the savings of bank depositors to finance itself and pay some foreign debt. After heavy withdrawals of deposits from banks on Friday, November 30, Cavallo announced a freeze of deposits on December 1. The deposit freeze brought much private-sector activity to a halt, because under the rules of the freeze, businesses and individuals could not use their deposits to pay anybody except other depositors at the same bank. The estimate of monthly economic activity calculated by Argentina’s national statistical institute suffered a year-over-year fall of 15.5 percent, the biggest since the series began in 1993. The economy plunged from what still might arguably have been termed a very bad recession into a true depression.

By December 20, minister Cavallo and president De la Rúa had resigned after deadly riots brought about by the shrinking economy and the deposit freeze. On December 23, the short-lived administration of president Adolfo Rodríguez Saá declared a default on the federal government’s debt to foreign private-sector creditors. The situation was by then so disorganized that default would have been almost impossible to avoid, but rather than presenting the default as a reluctant step by a debtor willing but unable to pay its bills, president Rodríguez Saá presented it as an act of defiance to creditors. He had ideas for other sweeping changes in economic policy, such as issuing a second national currency in parallel to the peso, but did not implement them because he resigned after a week following demonstrations against him.

Eduardo Duhalde, who became president on January 1, 2002, was a strong critic of the economic policies of the 1990s. He instituted revolutionary changes by devaluing the peso; forcibly converting dollar deposits and loans into pesos (“pesofication”); and voiding many kinds of contracts. He upset property rights that had been well established in Argentine law for at least a decade, and in some cases since the 1800s. The economy plunged further, with the year-over-year estimate of monthly economic activity falling a record 16.9 percent in January and 16.6 percent in March. The estimate did not turn positive until December 2002. The economy shrank 10.9 percent in 2002 following a 5.5 percent decline in 2001.

It is common for stabilization measures to take some time to work, but an already shrunken economy should not shrink 10.9 percent further if the measures really help rather than hurt. Unemployment and poverty rose sharply in 2002. The proportion of Argentines below the officially defined poverty line jumped from 38.3 percent in October 2001 to 57.5 percent a year later.⁸ It is estimated that about 40 percent of Argentines live on \$1 or less a day, and a further 20 percent on \$1 to \$2 a day. Exports fell 4.5 percent despite the huge boost the currency depreciation should have given. Exporters had difficulty obtaining credit because of the deposit freeze and government policies that made creditors afraid of further confiscations if they resumed lending.

⁸ Statistics are from the Instituto Nacional de Estadística y Censo.

Since about August 2002 the economy has recovered. The exchange rate has stabilized and even appreciated. Unlike the last severe bout of currency depreciation, in 1989, inflation did not spin out of control; the consumer price index rose 41 percent in 2002 and inflation may be in single digits in 2003. Production bottomed out, some export sectors began to expand, and by mid 2003 the recovery had become pronounced. From December 2002 to April 2003 the government removed the bank deposit freeze.⁹ The growth is welcome, but it may do nothing to change Argentina's disappointing long-term record.

On May 25, 2003, Nestor Kirchner, formerly governor of the southern province of Santa Cruz, became president as the result of an election on April 27.

III. WHAT COULD ARGENTINA DO NOW?

Seventy-five years ago, Argentina was one of the world's richest countries, with an income per person higher than France, Germany, or Sweden. Today it is a poor country. Argentina has experienced long-term economic growth, but it has been sluggish. What could Argentina do to raise its rate of economic growth?

In the monetary sphere, it could dollarize—replace the peso with the dollar as official currency. In the last few years, Ecuador and El Salvador have dollarized, with generally favorable results. The main rival option, a floating exchange rate combined with explicit or implicit inflation targeting, has worked fairly well in some other countries, but in Argentina's history, a floating exchange rate has always been associated with economic instability.

The Duhalde government cut some tax rates but raised others, especially on export products. The experience of Ecuador, which in 2000 combined dollarization with other economic reforms, suggests that considerable room exists to start cutting tax rates. Ecuador's tax revenue from sources other than oil has increased from \$2.5 billion from the depression year 1999 to a projected level of \$4.9 billion in 2003 because of economic growth and better enforcement. Revenue increased even though the government eliminated a financial transaction tax that in 1999 had produced 13 percent of nonoil revenue.

Argentina's banking system is recovering after a disastrous year in 2002. Its long-term health will depend on whether the economy is able to grow anew rather than simply rebound from the depression. Argentina's prospects of partly repaying the government debt on which it has defaulted also depend mostly on whether the economy can grow.

Over the longer term, Argentina faces obstacles to growth in a number of other areas. The obstacles are well known inside and outside Argentina, and all have been the subject of extensive study.

⁹ Argentina, Ministry of Economy, Resolutions 6/2002, 668/2002, and 236/2003; Banco Central de la República Argentina, Communication "A" 3827; Argentina, Decree 739/2003.

- *Rule of law.* Safeguards against takings of private property by the government are weak. The judicial system has a reputation for inefficiency and corruption. Violent crime became a big problem when the recession became a depression.
- *Tax strategy.* Real tax revenues are now rising as the economic recovery takes firmer hold. Real spending is not rising as fast because prices have not risen as fast as the peso has depreciated. The current budget surplus affords unusual political latitude to cut tax rates. Combining tax cuts with tax simplification and greater efficiency by the tax bureaucracy, Argentina could bring much of the underground economy above ground. It could change from a country that imposes high tax rates on a relatively narrow tax base to one that imposes lower rates on a broader base. Ambitious but not unrealistic goals over the next one or two presidential terms would be to reduce the value-added tax from the current level of 21 percent to 10 percent; reduce the payroll tax from the current level of 27 percent to 20 percent; reduce the top rate of income tax; and eliminate nuisance taxes, including the tax on financial transactions.
- *Federal-provincial financial relations.* Federal revenue sharing weakens the link between the taxes provinces levy and the revenues they spend. The federal government has not been willing to get tough with provinces that are essentially bankrupt. As a result, the provinces face weak financial discipline.
- *Government spending.* Spending on pensions and salaries of government employees, including superfluous employees, comprises a larger part of the budget than is desirable for a country at Argentina's level of economic development. Many expenditures lack transparency.
- *Labor.* Inflexible labor laws contribute to a high unemployment rate. Employers must pay heavy severance charges to fire employees, so they are less likely than employers in the United States to take a chance on hiring employees who may not work out. Argentina's statistical agency estimates that 40 percent of wage earners work in the underground economy. (Many of these people have first or second jobs in the above-ground economy.)
- *Health.* Government-run medical care is poor.

IV. POLICY IMPLICATIONS OF ARGENTINA'S EXPERIENCE

Policy on international financial crises. Since the Mexican financial crisis of 1994, there have been similar crises in large emerging market countries almost every year, as well as crises in many smaller countries. Some of the crises have had repercussions in U.S. financial markets. The response of the United States and other countries has been to intensify study of the problems involved, advance some solutions, and strengthen international financial cooperation through a number of means. However, since 1994, neither the U.S. government nor apparently any other government has articulated a comprehensive view about how to solve the crises. The main issues involved in recent international financial crises are exchange rate regimes; financial regulation; the role of international financial institutions, especially the International Monetary Fund (IMF), in resolving crises; and restructuring government and private sector debt. U.S. officials have already expressed ideas on all these topics individually, but have not

combined them into a clear and comprehensive view. Such a view should not be set in stone, but it should reflect what officials think they have learned from the experience of the crises since 1994, and should serve as a guide for future policy. Lacking clear views, the international community has in the last few years lacked consistency in its treatment of Argentina, which has contributed to erratic policy making by Argentine governments.

U.S. laws on foreign seizures of property. A number of the actions of the Duhalde government have had the effect of seizing property or nullifying contracts with U.S. citizens and corporations. There are several U.S. laws on the books whose aim is to discourage foreign governments from taking such actions.¹⁰ These laws have generally not been applied by successive administrations, nor has Congress pressed for their enforcement. Since the laws are dead letters, an obvious question is whether their continued existence serves any purpose.

The IMF's behavior toward Argentina. Argentina's problems are of its own making, but the IMF has made a number of important mistakes in the advice it has given and the actions it has taken regarding Argentina. The IMF supported tax increases to balance Argentina's government budget, albeit reluctantly. Raising the burden of taxation (the tax "wedge"), which was already high for the above-ground economy, discouraged economic growth.¹¹

IMF officials who have written or spoken for the public have persistently mischaracterized Argentina's convertibility system as a (fixed-rate) currency board system, which it was not. For example, unlike an orthodox currency board, it allowed its ratio of foreign reserves to liabilities of a monetary nature to stray far from 100 percent. IMF officials reportedly favored devaluing the peso, which proved to be hugely disruptive, because they thought it was overvalued, even though calculations in the IMF's own country reports on Argentina suggested otherwise. They discouraged consideration of dollarization (replacing the peso with the dollar as the official currency), in part on the erroneous grounds that it was technically infeasible.¹²

¹⁰ U.S. Code, Title 22, section 283r; section 284j; section 2370, subsection (e); section 2370a, subsections (a) and (b).

¹¹ Concerning IMF support for tax increases, see "Press Conference by Stanley Fischer, IMF Acting Managing Director," April 13, 2000, at <<http://www.imf.org>>. On November 16, 2003, the Duhalde government cut the value-added tax from 21 percent to 19 percent. The IMF pressured it to reverse the cut which the government did on January 16, 2003: "Presión del FMI: el IVA vuelve del 19 al 21% para recaudar más," *Clarín*, January 15, 2003, at <<http://www.clarin.com>>.

¹² Working papers and speeches on the IMF Web site offer numerous examples of failure to distinguish between the convertibility system and an orthodox currency board system. On the preference of IMF officials for a floating peso, see Anthony Faiola, "Argentina Plans to Devalue Peso; Anxiety Mounts," *Washington Post*, January 5, 2002, p. A17. On overvaluation, compare the remarks of Anne Krueger, the IMF's first deputy managing director and highest-ranking economist, with the IMF staff's calculations of the real effective exchange rate adjusted for unit labor costs (Anne Krueger, "Crisis Prevention and Resolution: Lessons from Argentina," July 17; International Monetary Fund, "Argentina: Third Review Under the Stand-By Arrangement, Request for Waivers and Modification of the Program," May 14, 2001, p. 10). It was also Krueger who said that dollarization was not technically feasible at the time; see Anne Krueger, "Transcript of a Press Briefing (Teleconference) on Argentina," January 11. All the IMF material can be found at <http://www.imf.org>.

By mid 2001 it had become apparent that the policies Argentina was trying were unsuccessful in restoring economic growth and reducing the growth rate of government debt. Even so, in September 2001 the IMF approved an \$8 billion increase in lending to Argentina. In December 2001 the IMF itself thought lending more money would be a waste of resources, and it ceased disbursing the rest of the loan.

When the U.S. Congress approved an increase in the U.S. contribution to the IMF in 1998, it attached certain conditions. One was that in cases where a country was experiencing balance of payments difficulties arising from a large and sudden loss of confidence, the IMF should charge an interest rate at least 3 percentage points above its low ordinary rate.¹³ This provision originated from *IMF Transparency and Efficiency Act of 1998*, introduced by Rep. Jim Saxton, then the chairman of the Joint Economic Committee.¹⁴ Of the nearly \$25 billion of loans the IMF has approved for Argentina since Congress set the condition, three-quarters has been at the IMF's ordinary interest rate (the "adjusted rate of charge"), which averaged 2.29 percent during April and May 2003¹⁵; only one-quarter has been at the rates of the Supplemental Reserve Facility, which at 3 to 5 percentage points higher are still far below what Argentina's government would pay if it could borrow in international capital markets.

On September 5, 2002, the IMF allowed Argentina to delay repayment of about \$2.8 billion in loans for one year. On November 14, Argentina defaulted on a loan from the World Bank. It missed a payment to the Inter-American Development Bank due January 15, 2003, and threatened to default to the IMF on loans due for repayment starting January 17. Argentina is one of the largest borrowers from all three institutions. A default by Argentina would have punctured the myth that they face no significant risk of default by member countries.¹⁶ To preserve the myth, the industrialized countries that are the IMF's largest shareholders pressured it to renew until August the existing loans coming due. The IMF's staff was reportedly reluctant to renew the loans, because ordinary procedures called for nonrenewal. On January 17, 2003, the managing director of the IMF announced he would recommend renewal, so Argentina did not fall into default even though it did not make the payment coming due. On January 24, the IMF board approved a total of \$6.8 billion in loans, whose effect was that Argentina would not have to repay any old loans coming due before August 2003. In effect, Argentina won a game of chicken against the international financial institutions and their biggest shareholder governments, setting a bad precedent for other large borrowers.

Borrowing, bailout, depreciation, and default. When facing mounting financial problems, governments in Argentina and other developing countries have often followed a four-step pattern: borrow from the domestic and international private sector; seek a

¹³ U.S. Statutes at Large, v. 112, part 4, p. 2681-219.

¹⁴ 105th Congress, H.R. 3331.

¹⁵ Countries that receive stand-by loans pay additional interest of 1 percentage point for borrowing over 200 percent of their quotas at the IMF, and 2 percentage points for borrowing over 300 percent of their quotas. As of April 30, 2003, Argentina owed funds to the IMF equal to 501 percent of its quota.

¹⁶ Some other member countries have defaulted, but their share of loans has been small.

bailout from the IMF and other sources in the international public sector when the private sector becomes reluctant to lend further; depreciate the currency as a form of taxation to obtain resources from the domestic private sector, so the government can continue paying creditors; and if that does not work, default. Argentina was unusual in that it defaulted shortly before devaluing rather than after devaluing.

Defaults by Russia in August 1998 and Argentina in December 2001 call into question whether the second and third steps are at all beneficial for countries paying high interest rates on government debt. By the time the IMF made its last loans to Russia and Argentina before they defaulted, their problems were not temporary ones they could have overcome with a year or two of breathing room from IMF loans. Rather, they faced lasting problems of financing their government debt, given the economic policies they were following. Bailouts increase an already high government debt. Currency depreciation can be disastrous for companies that have borrowed in dollars or another major foreign currency, which often is the only way to obtain medium- or long-term financing at predictable rates of interest. A case exists that if governments must default, they should do it sooner rather than later, and avoid depreciating their currencies to raise resources for the government to pay foreign creditors. Arranging an orderly default is hard, though. The U.S. government, in collaboration with other governments and the IMF, is attempting to develop procedures that would make defaults more orderly without encouraging defaults merely because a government finds its foreign debts irksome.

The importance of property rights to prosperity. The economic policies of the Duhalde government have overturned property rights constructed with great effort over the previous decade or longer. The tendency of the Duhalde government and most foreign observers was to treat the changes as mere differences of technique, and to neglect their revolutionary nature. In November 2001, Argentina was a country where contracts were generally (though not perfectly) enforced; bank deposits were secure; people were free to buy and sell foreign currency as they saw fit; price controls were few; and the government had honored its contracts with the companies, including many foreign companies, that were modernizing Argentina's infrastructure. By February 2002, Argentina had become a country where nobody could trust a contract; where the government had frozen bank deposits; people risked imprisonment for buying and selling foreign currency at market rates of exchange; many goods were subject to price controls; and the government had broken the contracts that had fostered private investment in infrastructure.

Where property rights are insecure, investing in the future becomes very risky, and economic activity focuses on achieving short-term gains rather than making long-term investments that can bring permanent improvements in productivity. Bringing long-term economic growth to Argentina will require respect for property rights rather than the frequent violation of them Argentina has seen during the last year and a half.

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