Argentina: Governance in Crisis

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Executive Summary

Although the origins of the crisis were to be found in poor economic policy decisions that led to a chaotic devaluation, its dramatic denouement in December 2001 and subsequent development over the course of 2002 were deeply conditioned by political factors. The Argentine crisis was and remains a crisis of governance in the most profound sense. It was neither predetermined nor unpreventable. In this sense it reflected a deep failure of the political class to adequately respond to the circumstances that confronted them. This failure was itself rooted in a tangled web of economic, political and socio-cultural incentives that touched every aspect of the Argentine political-economic system.

Understanding the reasons behind the Argentine debacle and why it unfolded in a sad parody of crisis over the course of most of 2002 is the purpose of this paper. The nature of the crisis requires a systemic approach to the problem and for this reason the paper will use the concept of governance to identify and examine the factors that contributed to it. This analysis then forms the basis for assessing to what extent the Argentine government has been able to master these challenges and lay the basis for self-sustaining economic and political development. It concludes with an assessment of the challenges for the future and recommendations for Canadian foreign policy towards Argentina.

Résumé

Bien que la crise tire ses origines d’une mauvaise politique économique dont les décisions ont mené à une dévaluation chaotique, son dénouement dramatique en décembre 2001 et les développements qui ont suivi en 2002 ont été profondément conditionnés par des facteurs politiques. La crise en Argentine était et demeure une crise de gouvernance dans le sens le plus profond du terme. Elle n’était ni prédéterminée ni inévitable. Dans ce sens, elle reflète l’échec flagrant de la classe politique à répondre adéquatement aux défis devant lesquels elle s’est trouvée. Cet échec lui-même a pris racine dans un enchevêtrement de motifs économiques, politiques et socioculturels qui ont touché tous les aspects du système politico-économique de l’Argentine.
Ce document d’analyse tente de comprendre les causes liées à l’intensification de la crise en Argentine et d’expliquer son déroulement, digne d’une triste parodie, pendant la majeure partie de 2002. La nature de cette crise nécessite une approche systémique et, pour cette raison, ce document utilise le concept de la gouvernance pour identifier et examiner les facteurs qui ont alimenté la crise. Cette analyse sert ensuite de base pour évaluer jusqu’à quel point le gouvernement argentin a réussi à relever ces défis et pose les jalons d’un développement économique et politique durable. Ce document se termine par une évaluation des enjeux qui se présenteront dans l’avenir et par des recommandations pour la politique étrangère du Canada à l’égard de l’Argentine.

Resumen

Si bien la génesis de la crisis Argentina ha de hallarse en el mal desempeño de las políticas económicas que condujeron a una caótica devaluación, su dramático desenlace en diciembre de 2001 y desarrollo posterior durante el 2002 fueron condicionados por factores políticos. La crisis Argentina fue y sigue siendo una crisis de gobernabilidad en su sentido más amplio. No fue ni anticipada ni inevitable. La crisis reflejó la incapacidad de la clase política de responder adecuadamente a las coyunturas que se les presentaron. Esta ineptitud a su vez estaba arraigada en una red intrincada de incentivos económicos, políticos y socio-culturales que incidieron en todo el sistema político-económico del país.

El presente trabajo se propone esclarecer las razones que motivaron la crisis Argentina y comprender porque su evolución devino una triste comedia en el transcurso del 2002. La naturaleza de la crisis requiere de un enfoque sistémico del problema. Por tal motivo, en este documento emplearemos el concepto de gobernabilidad para determinar y analizar los factores que propiciaron la crisis. Este análisis constituye la base para determinar hasta que punto el gobierno de la Argentina ha sido capaz de lidiar con estos desafíos y crear las bases para un desarrollo económico y político perdurable. Como conclusión se hace un balance de los retos futuros y se ofrecen recomendaciones sobre como el gobierno canadiense podría encausar su política exterior con respecto a la Argentina.

INTRODUCTION

On January 16, 2003, Argentina concluded almost a year of negotiations with the International Monetary Fund (IMF) with an agreement to rollover the repayment of its debt obligations to the IMF until August 31, 2003. Although a comprehensive agreement offering fresh money will have to wait until after a new president is elected in May 2003, the agreement was an important milestone in putting the Argentine economy back together again. It marked a full year and a full circle in Argentina’s fall from grace and painful struggle to reinsert itself into global financial markets.

The house of cards that was the Argentine economy by December 2001 finally came tumbling down in the wake two important decisions: in the last days of November 2001 a run on the banks prompted President Fernando de la Rúa and his economy minister Domingo Cavallo to impose a freeze on bank deposits known as the corralito (or “the playpen”); and on December 5, 2001, the International Monetary Fund refused to disburse a scheduled $1.3 billion SDR (Special Drawing Rights) tranche needed to pay debt obligations due in December and support the currency. These decisions put a chain of events into effect: widespread popular protests against the banking restrictions uniting unions, organized groups of the unemployed, their supporters and a broad section of the Argentine middle class; the repression of the protests by the federal police resulting in the deaths of several protestors; the resignation of de la Rúa; a series of four interim presidents culminating with the repudiation of the private debt and the appointment of Peronist kingpin Eduardo Duhalde as president; the devaluation; and the descent into a prolonged economic and financial crisis.

However, the events of December 2001 were merely the last stages of a crisis that had been brewing for several years. In comparison with 1998, by 2001 GDP had declined by 8.4%, and over the one year between September 2001 and 2002, GDP contracted by an additional 13.4%. Cumulatively, it is expected that the recession and crisis will have cost Argentina a decline of 15% GDP over its 1998 levels. But these figures do not adequately express the human tragedy behind what was also a social crisis. Unemployment in urban areas increased from 13.2% in May 1998 to 21.5% in May 2002, declining slightly to 17.5% in October of the same year.
The population living below the poverty line increased from 24.3% to 54.3% (in Greater Buenos Aires), and to 57.5% (in all urban areas) over the same period. And people living below the indigence line have more than doubled over the last year to account for 27.5% of the population (INDEC Argentina 2003).

Although the origins of the crisis were to be found in poor economic policy decisions that led to a chaotic devaluation, its dramatic denouement in December 2001, and subsequent development over the course of 2002 were deeply conditioned by political factors. The Argentine crisis was and remains a crisis of governance in the most profound sense. It was neither predetermined nor unpreventable. In this sense it reflected a deep failure of the political class to adequately respond to the circumstances that confronted them. This failure was itself rooted in a tangled web of economic, political and socio-cultural incentives that touched every aspect of the Argentine political-economic system.

Understanding the reasons behind the Argentine debacle, and why it unfolded in a sad parody of crisis over the course of most of 2002 is the purpose of this paper. The nature of the crisis requires a systemic approach to the problem and for this reason, the paper will use the concept of governance to identify and examine the factors that contributed to it. This analysis then forms the basis for assessing to what extent the Argentine government has been able to master these challenges and lay the basis for self-sustaining economic and political development. It concludes with an assessment of the challenges for the future and recommendations for Canadian foreign policy towards Argentina.

FAILURE OF GOVERNANCE

One way to think about governance is to ask how the system of formal and informal structures, rules, regulations and institutions that make up a modern state create incentives that influence (but do not determine) the political and economic behaviour of individuals and organizations. When this system generates perverse and anti-social incentives bad governance results. When this system works good governance and political-economic stability is the reward.

The trouble with the governance approach is that there is almost an infinite number of formal and informal institutions in any given society – including cultural norms. This paper will restrict itself to considering a limited number of key institutional structures that influenced the way Argentine political and economic actors reacted to the impending economic crisis and its development throughout 2002 and 2003:

- the exchange rate regime;
- the international context;
- presidentialism and divided government;
- federalism and
- the rule of law.

The incentives generated by these institutional structures in Argentina worked together in such a way as to make good governance difficult. The road to devaluation and crisis was not inevitable, but the country’s political and economic structures worked against policy innovations, political cooperation and the assumption of responsibility needed to stave off disaster.

ECONOMIC INSTITUTIONS AND THE ROAD TO DEVALUATION

There is considerable debate over the role played by the currency board known as the convertibility regime in the collapse of the Argentine economy and financial system. While some analysts continue to claim that it was almost the sole restraint on the alleged fiscal irresponsibility of the Argentine government, the balance of professional opinion tends to agree that after 1999 (if not before) an unwavering commitment to the convertibility regime, in combination with an unfavourable external context, made it difficult for Argentina to escape a vicious cycle of recession, deficit and increasing economic vulnerability.

The Convertibility Regime

The convertibility law, adopted in April 1991, was the brainchild of then economy minister Domingo Cavallo.
Convertibility sought to stabilize an economy that was emerging out of the 1989 hyperinflationary crisis by tying a new currency, the Argentine peso, to the US dollar at a one-to-one ratio. It was backed by the promise that the Central Bank (BCRA) would hold one dollar in reserves for every peso in circulation. Changing the law or devaluing the currency required a majority in the Congress.

The law was a hit: within a few months the inflation rate decreased significantly. Solving the inflation problem propelled the economy into a period of relatively high growth. Although the convertibility law was based on sound monetarist fundamentals, its real success was due to its effect on expectations. The inflexibility of the law and the extreme difficulty of changing it seemed to render both devaluation and fiscal irresponsibility (printing more money) a thing of the past. In combination with Argentina’s “star” status as a rapid and committed market reformer and the rescheduling of its debt under the Brady Plan, convertibility helped loosen international and local credit at reasonable interest rates.

But, convertibility and the liberal reforms (tariff reductions, privatization and deregulation) that accompanied it gave the economy only a temporary fix. By the end of 1998 the economy was beginning to enter a downward spiral. The causes of the recession remain contentious and analysts have cited several factors that came together in a vicious cycle of increasing deficits and declining confidence that proved impossible to break (Fanelli 2002; Fischer 2001; Jonas 2002).

An unfavourable external environment caused by declining terms of trade for Argentina’s exports, fallout from the Russian crisis (August 1998) and Brazilian devaluation (January 1999), rising interest rates, as well as the overvaluation of the peso due to convertibility, undermined growth and the government’s ability to balance its budget. Overvaluation in particular locked Argentina into an import-intensive model of development as cheap imports flooded the domestic economy and exports stagnated after 1997. The balance of trade in goods and services was negative for almost the entire convertibility period.

Without net growth in exports to balance increasing government spending in the mid-1990s, the negative balance in the current account made Argentina particularly dependent on capital inflows in the form of portfolio investment, foreign direct investment, and foreign loans to balance its accounts. Indeed, one of convertibility’s great contributions was its beneficial effect on investor confidence and foreign capital inflows. Ironically, this was also to prove its Achilles’ heel. When the economy entered recession in 1999 it found itself in a vicious cycle of declining confidence and investment, falling exports, shrinking tax revenue (value added taxes were dependent on growth), increasing debt service obligations and deteriorating balance of payments.

However, the federal government did stabilize then reduce public spending per capita after 1997 (with the provinces following suit in 2000) even as the need for such spending increased, but these reductions were offset by an increasing debt service burden and the rapidly contracting economy. At the same time, collection of the growth sensitive value-added tax (IVA) that accounted for 59% of tax receipts in 1996, collapsed, although it was partially compensated by a valiant attempt to increase income tax collection. Despite a series of austerity budgets, the government’s inability to balance its accounts (especially at the provincial level) prompted a surge in borrowing after 1998 and increased debt service obligations, which accounted for 25% of the federal budget in 2001. In this respect, the oft-cited charge that fiscal profligacy brought Argentina to the brink of collapse is only partially accurate. Rather, it was true that spending could not be cut as quickly as the economy was contracting.

Perhaps most importantly, the commitment to convertibility restricted the range of policy options...
with which to confront this crisis. The government was prevented from devaluing (as a way of compensating for the external shock and making the economy more internationally competitive) or initiating a fiscal stimulus to restart the economy. Pablo Gerchunoff and Juan Carlos Torre (1996) observed that these policy constraints had magnified the recessive impact of the 1994 Mexican devaluation in Argentina. With much more tragic consequences, a similar experience was repeated in 1998-2001.

### Status-quo Incentives

Despite the evidence that, at worst, convertibility by 1999 was a central cause of the recession (due to the overvaluation of the currency), and at best, did not allow the policy flexibility needed to adequately respond to the crisis, there was no serious attempt to abandon it. Over the course of a decade, convertibility had generated strong psychological, political and economic incentives that favoured the status quo.

The convertibility regime inspired an almost religious adherence from the majority of Argentines who viewed it as saving the country from the scourge of hyperinflation. It had become a popular symbol of a new Argentina, reformed, modernized and disciplined. But, fear of hyperinflation was the strongest sentiment in its favour. As a result, there was little political support for change and the regime was defended until the very end by President Fernando de la Rúa, Minister of Economy Domingo Cavallo and former president Carlos Menem (who argued for official dollarization of the economy). Those political leaders opposed to convertibility seemed to be voices in the wilderness: former president Raúl Alfonsín and Eduardo Duhalde during his failed 1999 presidential bid.

Notwithstanding the psychological attractiveness of the convertibility regime, it had other arguments in its favour. Most importantly, convertibility was an effective way of managing the existing debt and deficit. Debt overburdening had become a defining feature of the Argentine economy since 1983, when the private debt of the country’s largest firms was assumed by the state. Convertibility meant that the government effectively raised domestic tax revenue in US dollars, making the debt much more manageable (Schvarzer 2000, 139-143). The state, firms and individuals found easy access to credit in US dollars driving up the overall indebtedness in the economy, but allowing a significant economic expansion in the mid-1990s. Indebtedness created a strong political-economic constituency among powerful local conglomerates and the general population in favour of maintaining convertibility – as devaluation would cause debts to skyrocket. Convertibility allowed Argentines to think they were richer than they really were.

### The International Context

In addition, the confidence convertibility promoted in the international and investor community encouraged the inflow of both foreign direct and portfolio investment that helped to equilibrate the balance of payments - despite the fact that after 1997 convertibility itself was partially to blame for persistent deficits. Ironically, when the economy went into recession, Argentina’s dependence on foreign capital inflows increased (both in terms of debt and foreign investment) as a means of financing the exploding deficit. Any change to convertibility was perceived locally as “changing the rules of the game” and therefore undermining investor confidence in the economy. Ever hopeful of recuperating new foreign capital inflows (and finally balancing the country’s accounts), convertibility generated strong status-quo incentives.
The IMF also played an important role in supporting the convertibility regime by providing Argentina with financial support far exceeding its quota of Special Drawing Rights. As late as September 15, 2001, when the economy was already contracting rapidly and less than 3 months before Argentina would begin its dizzying descent into devaluation and economic chaos, IMF spokesman Thomas Dawson defended the then new IMF financing deal and its role in supporting the convertibility regime – mostly because of the risks of devaluation (Dawson 2002). By the late 1990s it was also clear that devaluation (thanks to the size of the debt) would also bring a debt default in its wake, widespread bankruptcies, and Argentina’s isolation from international financial markets. In this context both the government and the IMF saw cost-cutting as the least risky strategy. Balancing the budget was supposed to restoring the confidence of international investors and return Argentina to a growth path (Jonas 2002). The strategy put hope in convertibility’s confidence effect, while ignoring the currency board’s perverse consequences (effect on the trade balance) and the difficult external context.

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POLITICAL INSTITUTIONS AND GOVERNANCE

Notwithstanding the economic incentives generated by convertibility, the institutional structure of the Argentine state also mitigated against policymakers taking the economic and political decisions necessary to forestall the crisis. Institutions contributed to poor governance by creating incentives that undermined political cooperation, rewarded political opportunism and patronage, and weakened political responsibility.

Presidentialism and Divided Government

The Argentine presidential system tends to a variety of structural problems that undermine good governance and cooperation between the parties (Linz 1994). Principal among these is the problem of legislative deadlock when the presidency and Congress are controlled by different parties; the tradition of “hyper-presidentialism”; and the effect of electoral incentives on the behaviour of legislators.

Divided government and legislative deadlock have been persistent problems in Argentina’s new democracy, but were especially problematic for non-Peronist presidents. During Fernando de la Rúa’s abbreviated government, the Alianza did not have an absolute majority (more than 50%) in either the Chamber of Deputies or the Senate. In October 2001 it lost its plurality in the lower house to the PJ, leaving President de la Rúa without control of either chamber and unable to govern. In contrast, the Peronists under Menem enjoyed an absolute majority in the Senate during 1989-1999,
and when taken in conjunction with their conservative allies, the Unión del Centro Democrático (UceDe), an absolute majority in the Chamber of Deputies as well for much of the same period.

Fernando de la Rúa’s inability to maintain the Alianza coalition and articulate a convincing political vision was a personal failure on his part, but the structure of the Argentine electoral system also generated fragmentary incentives within parties and alliances. Once it was clear during the first year of his term that de la Rúa would be unable to improve the economy, and would be forced into increasingly unpopular adjustment measures, other parties (and individuals within the Alianza) realized that being associated with the government would harm their chances of being reelected in the mid-term elections. The flood of defections from the UCR in April-May 2001, and the increasing unwillingness of the opposition to support de la Rúa in a government of national unity, may thus be read as electoral manoeuvres in the face of the mid-term elections of October 2001.

The difficulty of working with Congress, even when controlled by the same party as the presidency, has encouraged the development of what Guillermo O’Donnell has referred to as “hyper-presidentialism” (O’Donnell 1994). Since Menem, presidential unilateralism and discretion has increased substantially (Llanos 2001; Peruzzotti 2001). The use of executive decree powers has marginalized the role of the congress in formulating, scrutinizing and passing legislation and undermined trust between the executive and the legislature. In addition the line-order (or partial veto) and regulatory function of the executive is also widely used to modify legislation passed by Congress. According to Mark Jones and Sebastián Saiegh, the tradition that has developed in Argentina is one in which the executive formulates and drafts major policy initiatives and the Congress plays the role of “blunt veto player.”

The structural problems of divided government are exacerbated by a winner-take-all political culture among the parties and the fact that political obstructionism (rather than cooperation) pays dividends. The premature collapse of Raúl Alfonsín’s 1983-1989 UCR government was facilitated by PJ opposition in the Congress and talking up the hyperinflationary crisis in mid-1989 (Canitrot 1994, 86). In 2001, the PJ’s refusal to cooperate with the Alianza in a government of national unity led to de la Rúa’s fall. These are worrying lessons because the crisis and failure of governance has already led twice in the last twelve years to the premature transfer of power – both times to the Peronists, even though the PJ was one of the reasons for the failure in the first place.

Federalism and Ungovernability

But it is not just the likelihood of divided government that makes governance difficult – as this tendency is present in most Latin American presidential systems. What sets Argentina apart is the interaction of these structural incentives for conflict with its highly decentralized federation. Mariano Tommasi, Sebastián Saiegh and Pablo Sanguinetti identify some perverse incentives in Argentine federalism that undermine good governance. Because of the political importance of the provinces in the Congress, federal-provincial negotiation is potentially at the heart of every policy debate. This increases the likelihood of special deals between the executive and groups of provincial governors. It also means that defending the parochial interests of the provincial governors often takes precedence over the national good. While the most important issues are dealt with in federal-provincial deals, implementation is difficult and inconsistent leading to opportunism and cheating by both the national and provincial governments (Tommasi et al. 2001, 173-183).

Provincial governors are the real power nodes of the Argentine political system. Governors are integrated downwards to the local mass base of party militants through a series of organizational levels that are ultimately based on patronage politics. In the case of the PJ, it is governors (or provincial party bosses when the party is not in power) who are able to mobilize, discipline, and finance the mass base of the party (Levitsky 2001, 48-50). The overwhelming importance of public sector employment in most provinces is a symptom of these patronage networks. This is also explains why many governors were unwilling to balance their provincial accounts.
But the influence of the governors is also integrated upwards into the national congress through provincial senators and deputies. Governors and provincial party bosses, rather than the national party executive have the last say in which members of their own party can run as deputies and senators (Levitsky 2001, 63-64). Since deputies and senators are elected by proportional representation based on their ranking on closed party lists, they owe their careers to governors and provincial party bosses more than to the people they represent or the national party leadership. Thus, in Argentina it is common for blocs of deputies to vote according to the wishes of their governor. In this respect, the provinces have a virtual veto in Congress, and president-governor deals are the key to governance.

The perverse incentives generated by Argentine federalism are also manifest in the financial relationship between the federal government and the provinces. Unlike Canadian fiscal federalism in which fairly straightforward equalization formulas and earmarked transfers (or tax points) determine the distribution of federal tax revenues to the provinces, the Argentine system is so complicated and discretionary that it has been described as a “labyrinth” (Jones et al. 2000, 152). The federal government’s failure to regularize Argentine fiscal federalism and reign in provincial deficits was one of the factors that directly contributed to the collapse of the convertibility regime thanks to the pervasive use of quasi-currencies (federal and provincial bonds used as currency) to pay public sector bills. By late 2001 the proliferation of quasi-currencies not backed by the central bank (as required by the convertibility law) had effectively undermined the monetary base of the Argentine peso.

But the failure to regularize fiscal federalism reflects the central importance of discretionary transfers in the Argentine system, both in terms of buying the support of provincial governors and maintaining patronage-based electoral machines (Manzetti 2002, 14-16). Within this system, there are few incentives for either governors to be fiscally prudent, or for the federal government to aggressively reign in provincial excesses.

The Rule of Law

Historically, Argentina has been known for the politicization of its institutions – including the judiciary. This has been a consequence of the naked and extended conflict between highly antagonistic political forces (Peronists and anti-Peronists) over the last fifty years. Each force hoped to use the state apparatus to advance its own interests and frustrate those of its enemies, thus resulting in the politicization of many key bureaucratic appointments. This has lead on the one hand to a state apparatus which has not been able to match the level of technical competence and professionalism found in other Latin American countries of similar development levels (such as Chile) and on the other, the politically opportunistic rule of law.

The classic example is the politicization of the Supreme Court. In 1990, President Carlos Menem expanded the Supreme Court from five members to nine. This enabled him to appoint a Court that was sympathetic to his political agenda. Menem sought to ensure that appeals to the Supreme Court against his wide-ranging neoliberal reform programme would not prosper. Menem’s politicization of the Supreme Court undermined what some observers had identified as an increasingly independent judicial branch since the return to democracy in 1983 (Peruzzotti 2001, 149-150). In this respect, the Constitution, rather than being a document which sets agreed limits on the political game, is still part of the game. Thus, the politicization of the judiciary has meant that the Constitution is not interpreted consistently over time, but is rather just another pawn in the more relevant game of power politics.

Luigi Manzetti has identified other serious problems with the rule of law during the tenure of Carlos Menem in Argentina, which included widespread corruption, the lack of qualifications in judicial appointments, the capture of the Supreme Court by the executive, and the use of executive “bullying” to produce rulings that met with the approval of the executive (Manzetti 2002, 12-14).
The road to devaluation and crisis was paved with bad incentives. After the economy entered a negative growth path, convertibility continued to generate strong incentives in favour of the status quo. In this context, the political will needed to break the vicious cycle of recession was considerable. However, the institutional incentives identified above worked to frustrate the political innovation and risk-taking necessary to avert a crisis. The PJ preferred letting de la Rúa fall than cooperating in a government of national unity.

The problem of divided government, the nature of Argentine federalism and the politicization of the Supreme Court undermined his ability to govern. Perhaps most importantly, there were too many incentives that rewarded political opportunism by both governors and legislators alike and which discouraged paying the political costs of either fiscal restraint or devaluation.

AFTER DEVALUATION: EDUARDO DUHALDE AND THE STRUGGLE FOR STABILITY

In the course of the two-week period between de la Rúa’s resignation and the first days of the Eduardo Duhalde administration, two important events occurred that would be fundamental in influencing the future development of the crisis. Interim President Adolfo Rodríguez-Sáa declared a wildly popular default on Argentina’s debt (excluding that owed to multilateral financial institutions) on December 23, 2001. And on January 4, 2002, newly appointed by Congress, President Eduardo Duhalde declared the end of Argentina’s 1:1 currency peg to the US dollar known as the convertibility regime. These two decisions resulted in a massive loss of faith in the Argentine currency and financial system. The Argentine peso entered a free-fall from parity with the greenback to approximately 25¢ by mid-April 2002 when it began to stabilize at that value. The pressure on the peso threatened to further discommodulate the domestic banking system as savers sought to defend their deposits by converting them into dollars or sending them abroad - necessitating the maintenance and strengthening of the banking restrictions originally imposed by de la Rúa. The banking restrictions and the freeze on credit further deepened the economic crisis.

The development of the Argentine crisis from early January 2002 onwards was thus characterized by several challenges: managing the corralito with a view to eventually unfreezing the banking system; restoring relations with the IMF and the international financial community; and negotiating a political exit from the crisis. The slow progress made by the Duhalde government as it struggled with these challenges over the course of 2002 underlined the extent to which the crisis was political and institutional – a crisis of governance. The same perverse institutional incentives that had led to poor governance and the collapse of the Argentine economy under de la Rúa frustrated Duhalde’s attempt to overcome the crisis and will continue to influence Argentina’s development into the foreseeable future.

The Corralito – A Political Problem?

Following the default and devaluation, the government of Eduardo Duhalde was faced with a number of important tasks needed to stabilize the economy including the gradual lifting of the banking restrictions (corralito), which had frozen savings in order to prevent a run on the banks. When Duhalde decreed the conversion, or pesification, of both dollar denominated debts (at a 1:1 ratio) and deposits (at a 1:1.4 ratio) to pesos, both savers and lenders found themselves paying a heavy price for the mismanagement of the economy.

From a practical point of view dollar deposits had to be converted to pesos (and eventually into long-term bonds) in order to ensure the viability of the banking sector which was under extreme financial pressure due to the pesification of its dollar denominated loans and increased levels of loan default during the recession and crisis. From a moral and constitutional point of view, many considered that their property rights had been violated by the pesification of dollar denominated deposits. Maintaining the government’s policy on the corralito turned out to be a political problem influenced by problems of governance.

On the one hand, the government faced considerable leakage from under the corralito as a result of rulings made by lower court judges authorizing individuals
access to their banking accounts. Evidence began to mount that some judges were freeing up accounts as a result of receiving bribes. However, a more serious problem for the government throughout April-October was the concern that the Supreme Court would rule against the pesification of dollar deposits. A Supreme Court ruling against the government would have been devastating and threatened the entire economic stabilization effort.

As one of its early initiatives, the Duhalde government had begun the impeachment (with the cooperation of the Radicals) of the members of the Supreme Court based on their politicized and pro-Menem rulings. Menem had appointed most of the Supreme Court judges during his decade in the presidency. A run of rulings against the government sparked fears that the Supreme Court was systematically opposing the Duhalde government because of the impeachment process. As a result, Duhalde backtracked on his original decision and sought to throw out an impeachment process that he himself had begun.

Duhalde believed that he could buy the cooperation of the Supreme Court by staying the charges against its members. Duhalde managed to secure the support of the major Peronist governors and powerbrokers who directed their congressional representatives to vote against pursuing the impeachment. The Radical Party and Alternativa por una República de Iguales (ARI), which supported the impeachment process refused to give the Peronists the quorum necessary to hold the vote for almost the entire month of September, but eventually relented fearing that they would bear the blame of the institutional stalemate. In early October however, Duhalde obtained the quorum necessary to win the vote – and the impeachment was shelved.

Regardless of the practical necessity of safeguarding the pesification of deposits and the integrity of the corralito, the affair reveals both the extent to which the rule of law was highly imperfect and politicized to begin with and the extent to which the executive was willing to use political pressure in order to influence the rulings of the Supreme Court.

Meeting IMF Conditions

Once President-for-a-week Adolfo Rodriguez-Sáa had declared a default on Argentina’s privately held debt, one of the most pressing tasks for the Duhalde administration was to negotiate Argentina’s readmission into the global financial community. Without an IMF deal, Argentina was cut off from global private capital markets and multilateral lending.

The conditions required by the IMF in advance of signing a deal included strict compliance of the federal-provincial fiscal pact (committed provinces to a 60% reduction of their deficit), the removal of quasi-monies (bonds issued by provincial governments to pay their wage bills) from circulation, the repeal of the economic subversion law (under which foreign bank executives were being investigated for aiding capital flight) and the bankruptcy law (which was viewed as being too debtor friendly), lifting the corralito, and devising a “monetary anchor” for the peso.

In practical terms, meeting the IMF demands required a federal-provincial agreement in which the governors both agreed to implement IMF conditions in their jurisdictions, and control the blocs of Deputies and Senators corresponding to each governor. Duhalde had found it difficult to impose discipline on the Peronist congressional representatives without first securing the agreement of the governors. There were three federal-provincial agreements that were the cornerstones for meeting the conditions set out by the IMF: February 27, April 24 and November 18. The February 27 meeting set the initial targets for reducing provincial deficits and a commitment to pass a new revenue sharing law, but also pesified provincial debt at favourable rates (effectively forcing the federal government to assume the costs of devaluation) if the provinces met their deficit targets. However, it was the April 24 meeting that marked a significant turning point in the management of the crisis.

Until that meeting, it was not clear that either the provinces or Duhalde were truly committed to implementing the IMF mandated adjustment policies designed by Economy Minister Jorge Remes Lenicov. Duhalde was a classic Peronist caudillo, opposed to the
Menem model of open neoliberalism, and many of his policy decisions reflected his populist credentials. Duhalde’s pesification of the debt, permissive bankruptcy law, and income support plan for families, reflected an willingness to defy the IMF. Early indications suggested that he was unconvinced of the need to deal with the IMF and was prepared to “go it alone.” Following the resignation of Remes Lenicov in mid-April, Duhalde organized a meeting with the governors at which he hoped to secure their support for a radical shift towards an inward-looking traditional Peronist recipe. In this respect, Duhalde’s policy vacillations seemed to reflect a genuine lack of commitment to carrying out the adjustment plan and reaching a deal with the IMF (Solá 2002).

However, in that meeting the provincial governors underlined that such a shift was unacceptable. It was from this point onwards that the need to reinsert Argentina into the world financial system became a real priority for the government. As a result, the provinces committed themselves to support the government in the Congress and do what was necessary to secure a deal with the IMF. For these reasons, the new economy minister appointed by Duhalde, Roberto Lavagna, was an orthodox economist with no ties to the Peronists.

Over the course of the summer of 2002 many of the economic demands made by the IMF were met, some by design, and others as the recession bottomed out and Argentina’s economic outlook began to improve. The IMF’s refusal to conclude a deal, especially as the Argentine economy began to improve and the government enacted a successful voluntary bond swap that improved the outlook for the banking sector (by converting deposits into long term bonds) and took steps to lift the corralito, looked increasingly capricious. The IMF policy towards Argentina contrasted with the rapid conclusion of major deals with Uruguay and Brazil in July. These deals reflected an attempt to justify the IMFs hard-line approach by isolating the Argentine problem and reducing the effect of financial contagion in the Southern Cone.

Since September 2001, the IMF had increasingly resorted to justifying its reluctance to sign a deal with the Duhalde government by citing the lack of political consensus in the country. With the campaigns of the presidential pre-candidates in full swing, several of the frontrunners were advocating renouncing a significant part of the debt and taking a hard-line towards any more concessions to the IMF. At the same time the Congress continued to frustrate IMF mandated (and executive approved) policy initiatives and was effectively paralysed for the entire month of September by a debate about whether or not to impeach the members of the Supreme Court.

In this context, on November 18th, President Eduardo Duhalde and twenty of the twenty-four provincial governors signed an agreement defining a new electoral calendar and meeting several of the persistent demands of the IMF – including the need for more political consensus. The twelve point Political, Economic and Social Accord agreed to by the governors included commitments to pass legislation in the national Congress (protecting creditors and technocrats working to restructure the banking system), approve the government’s budget and maintain exchange rate stability. With this federal-provincial agreement, Argentina seemed to have met the last of the IMF’s principal conditions.

However, by the time the IMF announced an agreement with Argentina on January 16, 2003 it was not clear that Argentina had succeeded in meeting its targets to the satisfaction of the IMF. Since making a show of the “political consensus” in the November 18 federal-provincial meeting, Argentina began to put pressure on the IMF by making the claim that it would not imperil its recovery by drawing on its reserves in order to make debt repayments due to the Fund, thus threatening to default with the international organization. Combined with pressure from the G-7 under the leadership of Spain and the United States’ interest in resolving the issue the IMF capitulated with a short-term debt rollover despite the reservations of its board of directors.

**Negotiating a Political Exit**

The famous quote about Rome burning while the Emperor Nero played his fiddle could apply with equal force to Argentina and its political class. The most
striking element in the political response to the crisis since January 2002 has been the way in which responding to the demands of the IMF and articulating a coherent strategy to deal with the crisis has consistently fallen victim to political bickering within the governing party.

Since Eduardo Duhalde assumed the presidency, one of his principal problems has been containing the struggle to replace him in the run-up to the presidential elections originally scheduled for September 2003. Faced with the decimation of the UCR following the collapse of de la Rúa’s government, the Peronists seemed virtually assured of victory and its internal leadership race about passing the presidential sash from Duhalde to his PJ successor. After Duhalde announced in early July that he would accelerate the election timetable to April 2003, the race to replace him kicked off in earnest.

The struggle set Eduardo Duhalde and his favoured candidate against his political foe, former president Carlos Menem. Duhalde had been frustrated by public opinion polls that consistently put Menem in the top two or three among both Peronist pre-candidates, and against presidential candidates from other parties. This was despite the questionable constitutionality of his reelection bid (according to the 1994 Constitution he should have to wait until the end of de la Rúa’s constitutionally mandated term before being eligible), and the fact that he has been under investigation for illegal arms sales, illicit enrichment, and facilitating a cover-up of the 1994 terrorist bombing of the Jewish Community Centre (AMIA) in Buenos Aires. In contrast, Duhalde’s early favourite, José Manuel de la Sota, polled a distant fourth and was unable to generate forward momentum.

The willingness of PJ leaders to play divisive power politics at a time when a common front was most needed speaks to the persistence of the win-at-all-costs political culture of the party. But an even more serious problem has been the manipulation of the legal framework governing the elections, which has been little more than an unadulterated attack on the rule of law. Duhalde forced open party primaries through Congress because he thought that while Menem might be selected by party members in a closed primary, he was unlikely to be selected by the population at large. When Menem continued to top the public opinion polls while de la Sota stagnated Duhalde sought to first postpone the primaries, then cancel them. Duhalde then floated the idea of a “lemas” law (so-called after the Uruguayan legislation of the same name) in which all PJ pre-candidates would complete directly in the presidential elections and the one winning the most votes would collect all the votes attributed to candidates running under the PJ banner.

Recognizing that the lemas law would lack popular legitimacy (it was too beneficial to the PJ at the expense of the other parties), Duhalde used his dominant position in the top organ of the PJ, the National Congress, to force through the adoption of a “neo-lemas” option in which all PJ pre-candidates would compete directly in the presidential elections with independent party organizations, but without summing the votes of those belonging to the same party. He also convinced the federal judge in charge of electoral law to reverse her earlier rulings requiring the Peronists to hold internal primaries. By changing the rules of the game, Duhalde ensured that Carlos Menem will not be able to rely on the PJ electoral machine to support his presidential bid, and that his own favoured candidate, Néstor Kirchner, governor of Santa Cruz, has a good chance of advancing to the second round of the presidential elections with the backing of the Buenos Aires provincial PJ machine.

Duhalde and his party have shown little respect for fair rules, impartially applied, which confer legitimacy. The neo-lemas law is explicitly designed to produce a victory for not only the PJ, but for Duhalde’s faction within it. Ironically this, together with the federal-provincial agreements he has secured, may be Duhalde’s greatest contribution to managing the crisis. As former governor of Buenos Aires province and Argentina’s most powerful Peronist caudillo, only he was capable of brokering deals and using the pressure-politics needed to bring the PJ into line. Although he has run roughshod over the rule of law, the politics of “dirty hands” were needed both to...
achieve federal-provincial cooperation, and bring discipline to the battle for the Peronist presidential nomination. Although Duhalde’s political methods make a constitutionalist squirm, it is hard to disagree with his goals. His personal commitment to crushing Menem’s reelection chances was vitally important in reducing the possibility that the presidency fall to a man who should have been excluded from consideration by the impartial operation of the rule of law. In a context where that was not possible, Duhalde’s brand of power politics may be considered a second-best option. But where Duhalde has failed is in laying the basis for deep institutional reform.

The Challenge of Institutional Reform

Duhalde’s preoccupation with the political power game for much of 2002-2003 should not obscure the advances that were made since the economy entered a free-fall in December 2001. Since that time, the economy has begun to show signs of reactivation and unemployment figures have started to decline for the first time since early 1999.

Despite the horrendous cost of default and devaluation which will be borne by Argentina for years to come, once taken, floating the peso will initiate a restructuring of the economy more in line with Argentina’s traditional comparative advantages – and encourage the rebirth of export-oriented agricultural and natural resource-based industries. The advances made in income tax collection should begin to bear fruit as the economy begins to grow and value-added tax receipts increase. In the near future, Argentina should be able to run a primary surplus. As it currently stands, however, the change in exchange-rate regime is the only major accomplishment – if it can be called that - of the de la Rúa-Duhalde transition. Just as too much faith was originally put in the miraculous effect of convertibility, there is a danger that getting off parity with the greenback will be the limit to institutional reform in Argentina. It would be a tragedy if so much suffering did not translate into an ambitious agenda of political and institutional reform – as it would condemn Argentina to repeat some of the mistakes of its past.

One of the most promising efforts to contemplate the deep reforms needed to solve the crisis of governance in Argentina has been through the Argentine Dialogue Table. The Argentine Dialogue was a cooperative project of the United Nations Development Program (UNDP) and the Catholic Church. It was given a mandate by Eduardo Duhalde on January 14, 2002 to initiate a dialogue between “workers, businessmen, NGOs, and the state itself” on how to overcome the grave social crisis afflicting the country. Duhalde also publicly declared that its findings would inform an ambitious agenda of constitutional reform. An editorial in La Nación in early February 2002 referred to it as “the only contemporary news that invites one to look to the future with hope” (La Nación, 03/02/02).

The Argentine Dialogue recommended wide-ranging institutional reform: reforming the political system to improve representation and responsibility; judicial reform to improve the independence and quality of the rule of law; improving the federal-provincial relationship; a program to reconstruct an efficient and technically competent state apparatus; and tax reform to improve fairness and collection. Its proposals included a timetable and identified the authorities responsible for designing and implementing the reforms (Argentine Dialogue 2002). The Argentine Dialogue shows the considerable creativity and intellectual capital of Argentines in identifying solutions to the problems that led to the crisis.

Hoping to attract the commitment and signatures of public figures, it was instead met with a cold shoulder. Only a few politicians ventured to sign it. In addition, Duhalde’s constitutional reform agenda found itself subordinated to the more immediate concerns of how to ensure that Carlos Menem did not win the Peronist presidential nomination and meet the specific economic and political demands of the IMF. By early 2003 all major reform efforts had been abandoned, and in the run-up to the April 27 presidential elections, old-style power politics dominated the political agenda.

CANADIAN POLICY OPTIONS FOR POST-CRISIS ARGENTINA

Canadian Investments in Argentina. The crisis has already damaged Canada’s image in Argentina. The
decision of the Bank of Nova Scotia to not re-capitalize its Argentine subsidiary Banco Quilmes and withdraw from the Argentine market has been the single most negative effect on popular perceptions about Canada for twenty years. Notwithstanding the legitimate business reasons behind Scotiabank’s decision, it has left Canada looking uncommitted and opportunist. The large number of Canadian investments in the natural resource extraction industry in Argentina (oil and gas, and mining), a sector that has historically been particularly vulnerable to nationalist backlash, suggests that it is important how Canada is perceived in Argentina. Promoting and publicizing good corporate social responsibility by both remaining and new Canadian investors may go some distance to repairing the damage done by Scotiabank.

The Free Trade Agreement of the Americas. Canada has been a vociferous advocate of the Free Trade Agreement of the Americas (FTAA) and the Summit of the Americas process since the Québec Summit of 2001. A comprehensive free trade agreement which liberalized the agricultural sector and ended agricultural subsidies would be a huge boon to the Argentine economy which remains highly competitive in many agricultural products. Argentina is scheduled to hold the next Summit of the Americas in 2005.

The International Monetary Fund and Argentina. Canada can exert leadership through its membership in the Group of 7 and its representatives on the IMF Board of Directors. In these forums Canada needs to press for both Argentina’s full reintegration in to the international financial system and support efforts by the government to address key structural and governance issues. Canada should support short-term debt rollovers with a view towards concluding a comprehensive IMF agreement with the new government that will take power in May 2003.

Political Reform. Political and institutional reform must happen in Argentina in order for the country to start on a path of stability and good governance. This challenge needs to be met from within, and there is little that Canada or the IMF can do to influence successful reform.

Canada could promote political and institutional reform through financial assistance targeted at respected civil society organizations (CSOs) and through bilateral technical cooperation agreements. Supporting the work of organizations such as the Argentine Dialogue should be a priority.

Canada’s long experience with some technical issues in our own evolving fiscal federalism could also prove useful to Argentina. The use of a simple equalization formula that responds to the changing fiscal needs of the provinces instead of discretionary transfers, the need to work towards reducing vertical fiscal imbalance (lack of correspondence between provincial expenditure and tax revenue) and developing provincial taxation capacity would go a long way to improving fiscal federalism. The sensitive nature of these issues means that Canada should invite Argentine politicians and technocrats to participate in technical workshops on fiscal federalism, or to send Canadian experts to Argentina through bilateral technical cooperation agreements. Such programmes must place the emphasis at the provincial level, where political resistance to reform remains strong.

LOOKING FORWARD

The failure of governance in Argentina is the failure to build an institutional environment capable of channeling the considerable intellectual talent of its people towards the common good. Poor governance lay behind the crisis and the way in which it was managed. Will the failure of governance continue to dictate Argentina’s future?

On April 27, 2003 the first round of the presidential elections to replace Eduardo Duhalde will be held. The process of setting the rules for the election has been characterized by many of the dysfunctions identified in this paper: possibly unconstitutional rule changes to favour Duhalde’s candidate; executive pressure on the judiciary to support the executive’s interpretation of the law; federal-provincial agreements in order to advance rule changes through Congress; and naked power politics played by opposing factions within the PJ. In the end Duhalde seems to have been able to impose his will on the Peronist party.
The elections themselves do not promise great change, as only two scenarios are probable. Duhaldé’s chosen successor, Néstor Kirchner could triumph, guaranteeing continuity in power for the Duhaldista faction, but at least securing good conditions for governability. Or an outsider may win (even a PJ outsider such as Adolfo Rodríguez Sáa) who has new ideas, but without the congressional and provincial support to implement them. In that second scenario, the failure of governance could become a recurrent problem.

One of the saddest outcomes of the Argentine crisis has been the subordination of long-term structural reform efforts to short-term considerations of political survival. With the conclusion of the presidential elections, and negotiations for a long-term deal with the IMF, at least this problem may change for the better. However, the ability of the traditional political class to implement reforms that strike at the very privileges and networks of power that have benefited them for decades remains extremely problematic. In this context, it is paramount that as the economy stabilizes, the agenda of deep structural reform is not forgotten and that the groundbreaking work of civil-society organizations such as the Argentine Dialogue remain in the public debate. Constructing institutions that generate the incentives that encourage responsible political and economic decisions by individuals and organizations remains the challenge to be met in Argentina.

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Further Reading


