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The Puzzle of Argentina's Debt Problem: Virtual Dollar Creation?

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Since the debt crisis of 1982, external debt continues to be one of the hot economic issues in Argentina. Argentina has the highest per capita income in Latin America – but also the highest per capita debt in South America. Unfortunately, Argentina's debt did not improve the living conditions of the majority of Argentines; on the contrary, only a very small group of families, companies and banks benefited.

The debt is no longer comprised primarily of loans contracted through the international banking system, and as a result, the default has affected them less than in the past. Currently, the funds are placed in bonds held by unknown creditors, many of whom are Argentinean. Another important part of the debt has been contracted with multilateral banking organisations such as the Inter-American Development Bank, the World Bank and the IMF.

As a consequence of a deep economic and social crisis since 1998, recession has been transformed into depression. As a result, the unemployment rate has risen to a 25 percent of the economically active population. If underemployment is added into the equation, unemployment reaches 50 percent of the economically active population. If poverty is defined as less than 4 dollars per day, it extends to more than half of the total population.

In the first part of this chapter, I outline the composition of the Argentine external debt by comparing it with other countries. An explanation of how and why the external debt has become a problem

follows. In the third section, I examine the debt in relation to the main problems of the Argentine economy. And I draw some conclusion about how to solve the external debt issue in the fourth section.

Composition and Evolution of the Argentine Debt

The Argentine external debt is comprised of the external debt of the public sector and the external debt of the private sector. In turn, the external debt of the public sector, along with the domestic debt from the public sector, constitutes the total public debt. Paradoxically, the major portion of the domestic debt of the Argentine government was contracted in dollars (although it was receiving pesos) as a manner of increasing the security to local lenders vis-à-vis the possibility of a currency devaluation. These local lenders were banks and pension funds. The operation was possible due to the bi-monetary Convertibility system, established simultaneously with the currency board. The fact that the local debt was contracted in dollars and received in pesos was one of the main factors that triggered the crisis of the late 2001.

By late 2000, the total external and domestic Argentine public debt represented 45 percent of GDP (see Table 1). The external public debt equalled 30 percent of GDP; the servicing of external public debt amounted to 2.4 percent of GDP and 23 percent of exports. The annual public and private external debt service amounted to 41 percent of total exports, and the total public and private external debt stock was equivalent to almost 5 times the annual exports.

This level of foreign debt does not appear dramatic if compared with that of other countries in the region or OECD countries. However, the high share of short-term external debt arouses a certain degree of concern.

Debt in Non-Existing Dollars

Ninety-eight percent of Argentine public sector debt consists of medium and long-term debt; 68 percent of the debt is made up of bonds and almost 30 percent is comprised of loans. The majority of which is owed to official bilateral creditors (Paris Club and others)

Table 1 Some Ratios Regarding the Argentine Debt
(as of December 2000)

	Percentage of GDP	Percentage of Exports of Goods and Services
Gross Public Debt	44.9	
Net Public Debt	41.8	
National Government External Public Debt	30.1	278.7
Net National Government External Public Debt	29.5	273.3
Gross External Debt	51.8	475.7
External Debt Service	4.4	40.6
External Public Debt Service	2.4	22.6
Short-Term External Debt	8.0	74.2

Source: National Public Credit Office, Ministry of Economy, Argentina.

Table 2 Argentine Public Debt
(as of September 30, 2001)

	Gross Balance (thousands of dollars)	Percentage
Total Public Debt	141,252,377	100.00
Medium and Long Term	138,010,419	97.70
Bonds	95,787,915	67.81
Local currency	2,269,830	
Foreign currency	93,518,085	
Loans	42,222,504	29.89
<i>International Organisations</i>	33,141,660	23.46
IADB	8,768,516	
World Bank	9,746,928	
IMF	14,592,372	
FONPLATA	27,792	
FIDA	6,052	
<i>Official Creditors</i>	4,826,919	3.43
Paris Club	2,038,589	
Other bilateral	2,788,330	
<i>Commercial Banks</i>	2,765,666	1.95
<i>Other Creditors</i>	1,488,259	1.05
Short Term	3,241,958	2.30
Treasury Bills	3,241,958	

Source: "Quarterly Estimates of the 2000 and 2001 Balance of Payments and Foreign Assets and Liabilities", Ministry of Economy, Argentina, March 2002.

Table 3 Evolution of Argentine Public Debt, 1997-2001
(by holder residence, in billions of dollars)

	1997	1998	1999	2000	2001 June	Sept.
Public Debt	101	112	122	128	132	141
External	73	81	82	81	79	87
Domestic	28	31	39	47	53	54

Source: "Quarterly Estimates of the 2000 and 2001 Balance of Payments and Foreign Assets and Liabilities", Ministry of Economy, Argentina, March 2002.

and international organisations like the IMF, World Bank and the Inter-American Development Bank (IADB). The full picture of the composition of the public debt as of September 30, 2001 is presented in Table 2.

Public sector debt can be divided into domestic and external debt. As shown in Table 3, the debt grew some 40 percent from 1997 until 2001. Sixty-four percent of this growth was contracted locally, implying that the domestic debt of the government almost doubled. The domestic debt was also contracted in dollars, and this is one of the key mechanisms that brought about the late 2001 crash, when the government was unable to reimburse dollars. In Brazil, the government was strongly indebted in reals and with devaluation it liquefied its debt; in Argentina, on the other hand, the devaluation aggravated the situation.

How did Convertibility work with respect to contracting public debt? Locally, the government offered dollar-denominated bonds while it received Argentine pesos at the standing rate of exchange, which was one dollar for one Argentine peso. With those Argentine pesos, it cancelled its local obligations, the pesos were circulated again, and finally they were deposited in dollar bank accounts or were used to buy new dollar-denominated public debt bonds. Thus, an accounting and debt in dollars arose, from dollars that never existed. There was a virtual dollar creation.

Debt Evolution

In the last 20 years, the external debt has grown at a much higher pace than the growth of the national product, as shown in Table 4.

In the 1980s, the debt more than doubled while economic growth for the period was negative. During the 1980s, Argentina did not

Table 4 Growth of Argentina's GDP and External Debt, 1980-2001
(percentages)

	Debt	GDP
1980-1985	81.5	-1.4
1985-1990	26.1	0.0
1980-1990	129.1	-0.7
1991-1995	61	20
1996-2001	32	2.8
1991-2001	139	15

	Debt	GDP
1995	15	-2.9
1996	11.3	5.5
1997	13.6	8.0
1998	12.6	3.8
1999	3.4	-3.4
2000	0.6	-0.6
Sept 2001	17.5	-4.5

Source: ECLAC, December 2001 LC/G.2153-P/E, and Secretaria de Programación Económica (various issues), *Informe Económico*, Ministry of Economy, Argentina.

have a policy of debt reduction. On the contrary, in 1986, Argentina failed to pay the debt for several months in a sort of concealed default until ultimately the debt was renegotiated with the creditor banks. Moreover, there was no analysis of which part of the debt was still valid and which part had already been cancelled.

As posed by Singer (1989), the 1980s witnessed a change in the paradigm of developing strategies; growth and development with employment, redistribution of income, satisfaction of the basic needs and a reduction of poverty were replaced by adjustment, stabilisation, structural change, and the opening up of the economy to the market. Argentina complied with this neo-liberal model, opening its economy, reforming the State, making adjustments, and engaging in privatisation; but the debt could not be reduced. Rather, it continued its climbing trend, as did unemployment and social unrest.

During the 1990s, in spite of economic growth reaching 15 percent, the debt grew even more than in the preceding decade, some 139 percent. The level of debt increased in spite of two sources of

Table 5 Stock of Foreign Direct Investment in Argentina
(balances at the period end, in millions of dollars)

	Private Financial Sector ^b	Private Non- Financial Sector ^c	Total	Index 1991 = 100
1991	1,334	10,190	11,524	100
1992	1,393	14,910	16,303	141
1993	1,748	16,772	18,520	160
1994	1,955	20,473	22,428	194
1995	2,528	25,463	27,991	242
1996	3,001	30,556	33,590	291
1997	4,507	37,506	42,087	364
1998	5,671	42,126	47,903	414
1999	6,403	55,523	62,037	537
2000	7,205	65,730	73,087	632
2001	7,012	68,986	75,998	659

Notes:

a Provisional figures.

b At book value.

c Book value estimates. As from the year 2000 the payments balance of flows were updated.

Source: "Quarterly Estimates of the 2000 and 2001 Balance of Payments and Foreign Assets and Liabilities", Ministry of Economy, Argentina, March 2002.

significant non-debt-incurring external funds income. One source was the privatisation of state-owned companies, and the other source was the entrance of foreign direct investment (FDI). From 1991 until 2001, FDI increased its stock by 559 percent (see Table 5). During the 1990s, Argentina was one of the favourite destinations for FDI flows to developing countries. For the international organisations, it was a "star" country that had followed all the policies recommended by the so-called "Washington Consensus".

An analysis of the debt evolution in the last 10 years (Table 6) shows that at the beginning of the 1990s, the public sector owned some 86 percent of the foreign debt, while in 2000 this share was reduced to 57.8 percent. The external debt of the public sector grew approximately 60 percent in the 1991-2000 period, while the external debt of the private sector reached as much as a 618 percent increase. The public external debt grew in spite of the fact that it was consolidated by the application of the Brady Plan in 1992. This plan converted the debt with banks into 30-year bonds secured by US

Table 6 Total External Debt per Sector, 1991-2001
(in millions of dollars)

	Non Financial Public Sector*, Central Bank	Per- centage of total	Non Financial Private Sector	Financial Sector (excl. Central Bank)	Total
1991	52,739	86	3,524	5,074	61,337
1992	50,678	80	5,774	6,520	62,972
1993	53,606	74	9,938	8,882	72,425
1994	61,268	71	13,842	10,799	85,908
1995	67,192	68	18,203	13,752	99,147
1996	74,113	67	20,841	15,659	110,613
1997	74,912	60	29,551	20,589	125,052
1998	83,111	59	36,512	22,306	141,929
1999	84,750	58	36,911	23,628	145,289
2000	84,615	58	36,949	24,775	146,338
Sept, 2001	90,957	62	35,671	20,222	146,850

Note:

* Including National and Local Governments.

Source: "Quarterly Estimates of the Balance of Payments and Foreign Assets and Liabilities", Ministry of Economy, Argentina. March 2002.

Treasury bonds that the Argentine government purchased using new debt, this time with international organisations.

Until late 1998, private external debt was concentrated in very few companies, 75 percent being held by 59 companies and 90 percent being covered by 100 first-tier companies, most of them subsidiaries of transnational companies. The liabilities of the privatised companies accounted for a significant 39 percent.

Maturities Schedule

The maturities schedule of the external debt is highly concentrated. In 2001, two refinancing facilities had to be obtained to avoid default. However, the maturities schedule for the next years remains highly concentrated. For both 2002 and 2003, the repayment of principal exceeds 80 percent of the exports. Adding interest payments of about 12 billion dollars, total debt servicing largely exceeds annual exports. The Argentine government has to purchase the dollars in the market,

Table 7 Medium- and Long-Term Debt Amortisation of External Debt
(as of September 2001, in billions of dollars)

	Total amount	Share	2002	2003	2004	2005	2006	2007	2008	2009 and +
Total	147	100%	22	22	18	11	7	10	10	22
Non Financial Public Sector and Central Bank	91	62%	14	16	13	9	6	6	6	20
Non Financial Private Sector	36	24%	6	5	4	2	1	3	3	2
Financial Sector	20	14%	2	1	1	0	0	0	1	0

Source: Undersecretary of External Financing, Ministry of Economy, Argentina.

while the Chilean and Mexican governments obtain a significant portion of the dollars for the debt payment directly from the exports made by their state-owned copper and oil companies respectively.

The public sector has greater amortisations than the private sector. Public sector amortisations even exceed 16 billion dollars in 2003. The devaluation of the peso at the beginning of 2002 made repayment of the public debt even more difficult. If the debt service accounted for 20 percent of the budget in the past, it is now more than 60 percent, while tax revenues are falling.

Comparison of Argentina's Debt with that of Other Countries

Argentina's public sector debt in relation to GDP has been lower than that of other countries such as Japan, Italy, Greece or the debt of the European Union member countries as a whole (see Table 8).

The debt to GDP ratio does not explain why the crisis broke through in December 2001. Nor does a comparison of Argentina's external debt to GDP ratio with other Latin American countries present a dramatic picture. Argentina's debt to GDP ratio is lower than that of Chile but higher than that of Brazil and Mexico (see Table 9). However, Argentina's debt to exports ratio clearly exceeds that of its neighbours Brazil and Chile. One of the reasons why Chile has a much lower debt to exports ratio is that its exports represent

Table 8 Public Debt of Selected OECD Countries and Argentina, 1999-2000
(as percentage of GDP)

Country	1999	2000
<i>Japan</i>	105	112
<i>Italy</i>	115	111
<i>Belgium</i>	116	110
<i>Greece</i>	104	103
<i>EU</i>	68	64
<i>Spain</i>	63	60
<i>Holland</i>	63	56
<i>Argentina</i>	44	46

Source: NewCronos: theme2/gov/gen_govt/gengovt/gengov95 and theme2/gov/gen_govt/pub_fin; "Quarterly Estimates of the Balance of Payments and Foreign Assets and Liabilities", Ministry of Economy, Argentina, March 2002.

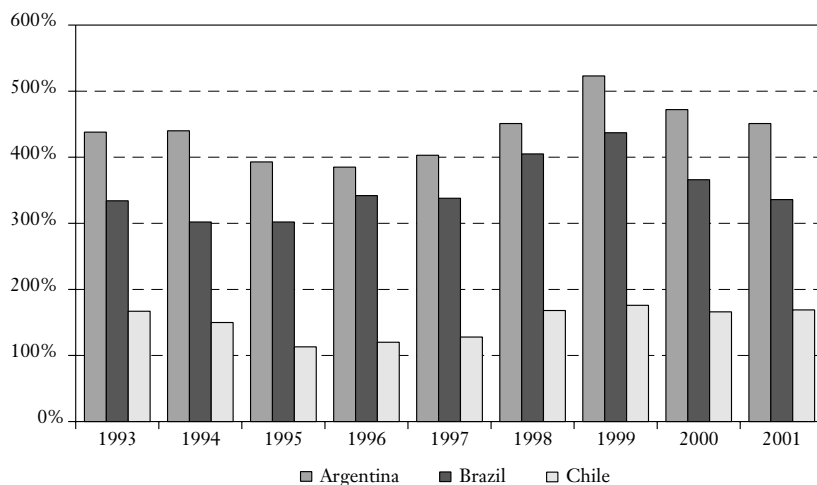
approximately 23 percent of GDP, while Argentina's exports represent only about 9 percent of its GDP, and Brazil's 11 percent. Since 1999, the debt to export ratio has been improved for both Brazil and Argentina.

There is an important additional reason why Argentina's debt to exports ratio is so much higher than that of its neighbouring countries. Argentina has been charged extremely high interest rates due to the increased country risk. Interest payments as a proportion of exports increased from 23 percent in 1993 to 41 percent in 1999 and 38 percent in 2000 and 2001 (see Table 10). The incidence of this high interest rate is one of the main causes for the public sector deficit and its advancing trend after 1997.

Table 9 Total Foreign Debt of Major Latin American Countries, 1999-2000
(as percentage of GDP)

Country	1999	2000
Chile	50.5	52.2
Argentina	51.5	51.8
Brazil	45.6	39.7
Mexico	34.7	25.9

Source: ECLAC, 2001.

Figure 1 External Debt as Share of Exports of Goods and Services, 1993-2001

Source: ECLAC, 2001.

The Argentine government has to purchase the dollars in the market, while the Chilean and Mexican governments obtain a significant portion of the dollars for the debt payment directly from the exports made by their state-owned copper and oil companies respectively.

Table 10 Total Interest Accrued from the External Debt as a Percentage of the Export of Goods and Services, 1993-2001

	Argentina	Brazil	Chile
1993	23	22	10
1994	27	18	8
1995	27	22	7
1996	28	23	7
1997	30	26	7
1998	35	27	8
1999	41	32	8
2000	38	26	8
2001	38	25	9

Source: ECLAC, 2001.

A Closer Look at Argentina's Virtual Dollar Creation

As a special feature of Argentina's financial system after the introduction of Convertibility in 1991, it became possible to make dollar-denominated deposits and loans, thus creating a real bi-monetary system. From 1991 to 2001, the total of deposits grew by almost 350 percent. During this period, the dollar-denominated deposits grew over 600 percent reaching some 71 percent of total deposits by 2001.

If we consider that the accumulated deficit of the current account of the balance of payments was 93,587 million dollars from 1991 to 2001, that the deficit was covered by direct and portfolio investments on the one hand and bank loans and public bonds on the other, and that during that same period the international reserves were substantially increased, the question is: where did the dollars come from to make deposits of 46,734 million of dollars possible, as shown in Table 11?

The answer is simple. In Argentina, there was an important creation of book or virtual dollars born from the credit multiplier and the possibility, under Convertibility, of establishing dollar-denominated deposits just by delivering pesos to the bank. When the crisis broke out and the customers tried to withdraw their deposits, the banks were unable to respond because there were no dollars available.

The naive explanation given by the banks to justify their lack of liquidity is that they had lent at longer terms than those of the deposits they had taken. So they admit that they failed to comply with one of the golden rules of the banking system. Moreover, the foreign banks attracted customers by advertising the support given by their head offices in developed countries. But when the crash occurred, there were few head offices that backed up their Argentine branches.

To stop the run against the banks, the government tried to freeze the deposits early in December 2001, by placing a curb on the deposit holders and not allowing them to withdraw their money, the so-called "corralito".

With regard to loans (Table 12), the growth process is similar to that of the deposits, but since bank reserves required by the Central Bank increased, their multiplier was restricted. The government is a large borrower of internal credit; in 2001 it borrowed some 30 percent of the total credits of the system and 36 percent of the

Table 11 Deposits in the Banking System in Argentina, 1991-2001
(in millions of dollars)

	Total	Pesos	Dollars
1991	14,624	8,064	6,580
1992	24,407	13,665	10,742
1993	37,863	19,770	18,093
1994	44,866	21,859	23,007
1995	42,595	19,182	23,414
1996	52,258	24,564	28,194
1997	68,500	31,796	36,704
1998	76,794	34,831	41,963
1999	78,662	32,607	46,055
2000	83,913	32,004	51,909
2001	65,601	18,867	46,734

Source: National Administration of Macroeconomic Policies Coordination, *Economic Report*, Ministry of Economy, Argentina.

dollar-denominated credits. The banks preferred lending to the government because it borrowed larger amounts and paid higher interest rates than other borrowers did.

By the end of 2001, the loans to deposits ratio was almost one to one, and had been reduced significantly since 1991 when credit facilities more than doubled deposits. The banking system had become more solid. However, when the crisis came, it was not solid

Table 12 Banking System Lending, 1991-2001
(in millions of pesos and dollars)

	Total	To the Public Sector		To the Private Sector	
		Pesos	Dollars	Pesos	Dollars
1991	30,940	6,088	2,794	12,485	9,573
1992	42,635	4,643	4,400	17,659	15,933
1993	51,391	5,640	3,528	20,746	21,477
1994	52,275	1,721	3,429	19,743	27,382
1995	52,388	2,088	3,544	18,233	28,523
1996	57,592	1,926	4,432	19,549	31,684
1997	66,935	1,766	5,244	22,032	37,893
1998	76,406	1,479	7,837	24,241	42,350
1999	77,232	1,676	10,316	24,385	40,856
2000	76,986	826	14,134	23,286	38,740
2001	72,004	1,006	20,837	14,046	36,116

Source: National Administration of Macroeconomic Policies Coordination, *Economic Report*, Ministry of Economy, Argentina.

enough due to the lack of “real” foreign currency instead of the “virtual” dollars created in the system.

When and Why did Argentina’s Debt Become a Problem?

The figures of the debt alone cannot explain the magnitude of the impending Argentine crisis. Many factors combined to cause a long awaited crisis in December 2001. On one hand was the tightened schedule of debt repayments and the high interest rates that had to be paid for each renewal and refinancing of overdue debts. Risk-grading companies began increasing the country risk of Argentina from market information that the banks themselves manipulated when entering and leaving the bond market, thus causing an interest rate hike, which they then charged for refinancing facilities. On the other hand, there was the so-called “blindaje” (shielding), a shielding system with a significant funding from the IMF, and the so-called “megacanje” (mega-exchange), a significant exchange of public bonds.

Another cause of the crisis was the reduction of capital flows to Argentina after the Russian crisis. Capital flows quickly decelerated as recession advanced and uncertainty increased as a result of the unclear political situation when the Argentine vice-president resigned. No less important in the emergence of the crisis was the recurrent deficit in the current account balance. This deficit was due in part to the high interest payments and to higher imports. Although exports doubled from 1993 to 1998, the fixed and overvalued rate of exchange fostered imports, which more than doubled in those years.

At the same time, tax revenues fell with the recession of the economy. To fill the gap, the public sector incurred dollar-denominated domestic debt. The results of this policy were aggravated by the increasing dollar-denominated deposits generated in the financial system. The account holders opted for dollar deposits to protect themselves in case of a devaluation or Convertibility drop off. The attitude of delaying consumption aggravated the recession. One other factor that is often mentioned as a cause of the crisis, the fiscal deficit, remained within reasonable limits and cannot be blamed as a direct cause of the problem.

The Convertibility Trap

One of the reasons the Argentine crisis was not avoided was that nobody could provide a consistent and timely exit from the Convertibility regime. The IMF failed as well as those who departed from the Convertibility regime without having a clear plan of where to head or how to handle the problems that would arise. The Convertibility model may have been useful during the first period when it was necessary to achieve stability after two hyperinflation processes in 1989 and 1990. But not only was the exchange rate fixed, also a bi-monetary system was established that allowed depositors to make local deposits in dollars, and to contract and rent in dollars. It allowed the government to assume internal debt in dollars in exchange of pesos.

Since no money could be issued internally to provide liquidity, the monetary restrictions imposed by Convertibility were overcome by issuing debt bonds. Provincial authorities, in turn, issued internal debt bonds in the manner of bank bills of legal tender to create liquidity.

Hausmann is one of the few analysts who proposed one of the most coherent manners of abandoning the Convertibility regime before the crisis. His solution had two main ingredients; on the one hand de-dollarisation of dollar-denominated bonds, both in the domestic financial system as well as in the pension system and all types of internal contracts. On the other hand, a floating exchange arrangement anchored by inflation targets. The objective was that Argentina would be competitive again and, at the same time, avoid the problems generated by dollar liabilities in the event of a devaluation.

Amid the crisis, Gaba (2001) proposed three alternatives to exit the Convertibility regime: 20 percent devaluation and further dollarisation, devaluation and flotation, keeping the bi-monetary system as in Peru, and free flotation and de-dollarisation as Hausmann proposed. Devaluations would imply relative changes in prices, which foster exports and discourage imports, resulting in an improvement in the balance of payment, but at the same time devaluation might imply a greater capital flight thus neutralising the effect of exports improvement. Therefore, some kind of control to capital movements and possibly exchange controls would be necessary.

In the end, however, the worst solution was chosen: devaluation with flotation, asymmetric devaluation of deposits and credits with a fixed exchange rate and controls to deposits withdrawals, converting short-term deposits into medium and long-term bonds.

Inoperable Solutions

During 2001, different solutions that ultimately did not prevent the crisis were attempted: the most important ones were the so-called “blindaje” and “megacanje”.

“Blindaje”

In March 2001, the Argentine government announced an agreement with the IMF, approved in May of the same year, with a significant disbursement. Together with contributions by the Inter-American Development Bank, the World Bank, the Spanish government and others, this would secure a principal amount that would allow meeting future amortisation. At that time, the government said that thanks to the “blindaje”, Argentina would be in a position to meet future commitments without having to place more bonds in the international market. However, a few months later a new refinancing transaction was announced, the “megacanje”.

“Megacanje”

By mid-2001, the economic authorities, initiated a process by means of which bonds with maturities in the short and medium term were exchanged with others with maturities in 7, 15 and 30 years, held by banks in Argentina and pension funds. The objective was to improve the maturities by extending them in an attempt to decrease the fear of default and also to decrease the country risk and thus alleviate the burden of interests in the debt service by securing lower interest rate credits.

This transaction was officially estimated to amount to 20,000 million dollars, hence it was called the “Megacanje”. The government thought this transaction would be a financial relief in terms of repayment of principal and interest payments of around 4,500 million dollars annually and that they could thus avoid default.

For a number of reasons, this transaction was not successful. First,

the interest rates were not decreased significantly, which became evident less than a month after the events of September 11, 2001, with the steep decline of international interest rates. Second, the transaction itself lacked public support and served to deepen the crisis of confidence in the government. A group of banks selected by the economic authorities collected such substantial amounts of money in commissions on the exchange transaction that even the United States government offered to assist Argentina in future exchange transactions free of charge.

The transaction was guaranteed, for the first time after the Second World War, with tax collection thus opening the possibility for foreign banks to collect and intervene in the domestic economy. A similar situation had occurred in the province of Catamarca, Argentina, in the 1930s when a foreign bank intervened in the tax collection board to secure repayment of a loan.

Debt in the Context of a New Development Agenda

When Argentina's debt was rescheduled according the Brady Plan in 1992, it was expected that this would be the last rescheduling of Argentina's external debt. However, starting from the Brady Plan, the debt continued growing until it doubled again in less than 10 years. It became necessary to reschedule amortisations every year.

In spite of privatisations, proposed by the so-called Washington Consensus grounded on the belief that these would decrease the external debt, the debt continued to grow. The other argument in favour of privatisations was that it was believed that they would decrease the public deficit by removing subsidies paid by the government to maintain inefficient public utilities. The railway system, for example, was subsidised by the government at 2 million dollars per day. However, after the privatisation and after reducing one of the world's largest railway networks to half its size – leaving several towns with no communications, severing thousands of persons from service, and resulting in worse service – the government continues to grant the licensee a two-million dollar daily subsidy, equal to the previous one.

Another target of the privatisation process was the pension system. This privatisation anticipated the development of a capital market that would allow financing growth. But, once privatised, the

largest portion of these pension funds was loaned to the government at high interest rates, worsening the fiscal deficit. Prior to privatisation, these funds were directly collected by the government.

Yet, another neo-liberal measure taken in 1996 to recover the economy and employment level was the reduction of employers' contribution to the pension system. This reduction represented 10 percent of tax collection. But employment did not grow and the government, being deprived from this contribution, increased its fiscal deficit.

The Brady debt agreements and liberalisation and privatisation measures were expected to bring about a growth that would reach the entire society, but income inequality and unemployment rose, resulting in resentment and the feeling that the policy change and the debt incurrence did not help the country develop, but rather it caused it to regress.

Argentina's external debt cannot be separated from its economic development, therefore it must be treated within a model of development that improves the Argentine standard of living, generates employment and prevents economic stagnation. Argentina needs a debt rescheduling that relates debt service to public and private sectors' income. This would allow starting an investment process leading to a sustained human development process.

A new development agenda is required. It is also necessary to revive the economic objectives that existed prior to the neo-liberal policies, i.e. growth, full employment, income distribution and internal and foreign account macroeconomic stability.

How can one start a growth process in a country like Argentina that has not experienced growth since 1998? Why has the growth dynamic been exhausted? Last year's dynamic growth resulted from investments made in privatised companies and some industrial sectors with particular sector policies, such as the automobile sector. But the income concentration dynamics tightened the internal consumption market constantly and deprived productive investment from incentives.

The functional distribution of income in the US in 1990 meant that the return for labour was 74 percent of domestic income while the return for capital reached 26 percent of income. In Argentina, the opposite is true, i.e. workers receive 26 percent of income and non-salary earning people receive the remaining 74 percent. This means that the wage earners' market does not represent an attractive

market for domestic or external investors. In a growth process based on investments oriented to lower income sectors, progressive income distribution is necessary. Some countries, like Japan and Korea, have shown that it is possible to distribute before growth starts. Waiting until you grow and then distributing does not generate any enthusiasm because that time never arrives.

Income distribution is also necessary to address the difficult social situation. The crisis has widened the gap between rich and poor from 1 to 30, thus increasing the country's economic social heterogeneity. This means that, in addition to getting smaller, if markets increase heterogeneity, production increases its heterogeneity and the old scale problems that appeared at the commencement of the industrialisation process crop up again. The road toward a more participative social economic process becomes more difficult to journey in view of the loss of balance of internal sectors. There is no opposition with enough power to balance the unbalanced "market" decisions of big players in the market, like the financial sector and large local and foreign economic groups.

The alternative to the present policy led by the "Washington Consensus" in Argentina is the creation of those counterweights so that a more equal society and economy can be developed with alternative economic and social policies. Stiglitz says that "one of the most important elements in any economy is the social capital and whoever ignores this does not understand how a modern economy functions."

Argentina and Globalisation

Argentina's debt grew in the last 10 years as a result of Convertibility. Neither the privatisations nor the large increases of foreign direct investment were enough to provide the system with the necessary dollar liquidity. The fiscal balance deteriorated, due to rising interest rates paid on both the internal and external debt. The fiscal deficit was not the direct cause of the crisis, but a consequence of the economic situation.

The possibility of having deposits stated in dollars generated an important amount of such deposits that multiplied from credits made in dollars, even though pesos were used in these transactions. When depositors tried to withdraw their deposits, the dollars were not there

because they had never existed. They were virtual dollars. The passive role given to the Central Bank due to the Convertibility system, sped up the crisis.

Argentina's external debt default was a rapid, insufficiently analysed measure that worsened the general situation. A general rescheduling with an interest rate, maturity and debt service revision, should have been posed and negotiated on the basis of the actual payment possibilities of the country. Otherwise, a new rescheduling would be necessary year after year with the problems generated by "blindaje" and "megacanje".

The problems that Argentina is facing will not be solved rapidly. Since the problems are not only financial, it will be necessary to propose a development model different from the existing one and define the country's involvement in globalisation. The external debt policy should accompany this process and the international financial institutions that share responsibility for errors made by Argentina, should understand that.

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