

## **Lecture 6**

### **Argentina until de Brazilian Crisis**

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By the second semester of 1998, Washington considered Argentina the most successful economy amongst those that had restructured their debt under the umbrella of the Brady Plan.

By that time, no ‘Washington Consensus’ sponsor would acknowledge that Argentina’s economic reform package differed in several aspects from the 10 policy recommendations that constituted the core of the so-called Washington Consensus. On the contrary, Argentina was pointed out as the IMF, the World Bank and the US Government “best student.”

Carlos Menem, Argentina’s President at that moment, was invited to join Bill Clinton at the podium at the IMF-World Bank Annual Meeting that took place in Washington in October 1998 and to offer an address on his successful experience.

Many Argentine economists were invited to explain Argentina’s experience in international conferences and seminars. Everybody praised Argentina’s performance.

Having been the most important Minister of Menem’s Administration during seven years, I resigned in 1996. After leaving I kept denouncing the mafias I had fought against while in the Ministry because they continued operating somehow protected and interacting with those in power. When I was invited to give talks or speeches abroad, those comments were not welcomed. I was considered too critical of Menem’s government. They said that I had become an ambitious politician and by the same token, they evaluated my successor at the Ministry, Roque Fernandez, as a more orthodox and less politicized economist.

The description of Argentina’s 1989-1998 economic reforms provided by the readings is detailed and thus, I am not going to revisit them. Instead, I would like to comment on different aspects of our experience that I find relevant in order to understand how the decisions were made and how the reforms were designed. I will also mention to what extent we learnt from our neighbors and from our own history and what the influence of the “Washington Consensus” was.

The first strategic decision Menem made after his inauguration was not in the realm of the economy but in the foreign policy arena. Menem decided that Argentina should become a trustworthy nation to its neighbors, to the US, to Europe and to Japan, and to the extent possible to every nation in the world.

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This line of action may seem obvious. It was not. It was a profound change in Argentine politics. Argentina had had a distant and sometimes conflictive relation with the US ever since the First Pan American meeting in 1890. The relationship with Europe had deteriorated due to the South Atlantic War, which was still unsolved because the peace had not been signed. Furthermore, we did not have diplomatic relations with the United Kingdom. Close to home, Argentina had been at the brink of fight a war against Chile in 1978 and we still had border conflicts with our neighbor. On the other hand, Argentina and Brazil had embarked in a very expensive nuclear race, and none of those countries had ratified the Tlatelolco Treaty, which aimed at preventing the existence of nuclear weapons in Latin America. On top of that, Israel secret service had disclosed that Argentina's Air Force was secretly developing a middle-range missile to be exported to Iraq. Also, Argentine state-owned companies after signing partnerships with Japan investors had stopped the projects without notice or explanation.

Guido Di Tella and I had noticed that Argentina's international situation was Menem's primary concern. Although we were two of the economists Justicialist leaders would listen to the most and Argentina's economy was facing collapse, Menem would seek our insights on foreign policy rather than on economic matters.

Back in 1989, Menem was convinced that the changes that were taking place in the world would open a window of opportunity for progress and advancement to those nations ready to seize them. In order to take advantage of the opportunities he envisioned will come out, nations rather than get isolated should actively seek to be part of the globalization process. Menem had in mind that by the turn of the XX Century, Argentina enjoyed one of the ten highest per capita incomes in the world. This achievement had been possible because the country had been able to take advantage of the opportunities offered by the globalization process that took place at that time. Naturally, we shared his vision.

Instead, Menem still endorsed the traditional Peronist corporatist mindset regarding economic organization. It was then not surprising that he appointed the CEO of the largest Argentine multinational company as Minister of Economy, and a union leader as Minister of Labor. Back then Menem did not have a clear strategy of setting "Rules of the Game" for the economy. On the contrary, he used to make decisions based on the urgent problems at hand or in relation to topics that his closest advisors or the Ministers themselves brought to his attention.

The decision making process did not follow a clear order and produced limited good results. By the beginning of 1991 stagflation was rampant and hyperinflation was a constant threat. Meanwhile, Menem's positive image had fallen to a low 15%.

Nonetheless Argentina had made progress in international affairs. Argentina was able to establish good international relations with its neighbors, Chile and Brazil, and it had also improved its relations with the US, Europe and Japan. It had also been involved in the Gulf War as a member of the International Task Force sponsored by the United Nations Organization, which in turn helped Menem to establish a close personal relationship with George Bush.

In 1991 Menem restructured his Cabinet. I was appointed Ministry of Economy and Guido Di Tella became Minister of Foreign Affairs. Up to that moment, Di Tella had

been Argentina's Ambassador to the US and I had served as Minister of Foreign Affairs. At that very moment, Menem made the decision to produce a complete overhaul of the economy. He had understood how important was to provide the economy with clear and foreseeable "Rules of the Game" in lieu of decision-making processes based on discretion and urgencies. We had had long talks about these issues when we traveled together while I was his Chancellor.

I drew heavily from Chile, Bolivia and Mexico experiences when I outlined the plan, and used these examples when I explained my ideas to Menem. Chile was an excellent example regarding openness, privatization and deregulation. Bolivia, in turn, was a very good case study in relation to monetary policy because as well as Argentina, they had suffered a hyperinflationary process that ended up in a de-facto dollarization of the economy. Finally, Mexico had gotten US support to restructure its external debt with a 35% discount.

Menem envisioned that an intense political work would be needed in order to obtain the support of the Peronist Party, the Congress and the Governors. No doubt, the milestone would be the Monetary Reform. Notwithstanding, a Monetary Reform would not produce results by itself. On the contrary, it should be accompanied by a new budget system, balanced and accountable, by opening up the economy and by introducing competition in markets.

An immediate success against hyperinflation would grant his Administration the necessary support from the public opinion and the political leaders. We needed to use this support wisely and quickly to bring about all reforms needed not only to consolidate the stabilization process, but also to foster economic growth. We foresaw that introducing this reform package we would be able to offer Argentina a long period of sustained economic growth.

In the years that followed, the outcome was astonishing. Inflation went down from its hyperinflationary level to a 3% per annum in 1994. The economy grew 38% in 4 years. The Peronist Party won the parliamentary elections in 1991 and most of the Governorships. In 1993 Menem reached an agreement with Raul Alfonsín, the leader of the opposition party, to amend the Constitution, which allowed him to be reelected in 1995.

In 1991 Argentina formed MERCOSUR, the regional trade block in the Southern Cone, along with Brazil, Paraguay and Uruguay. In 1994, our MERCOSUR partner, Brazil, decided to launch an economic reform package along the same lines of Argentina's, although not that structured and complete. That plan, called the Real Plan, had very good results both in terms of reduction of inflation and growth. This coincidence, then, brought about a harmonious period between the two nations.

At the beginning of 1995 the Tequila Crisis had a harsh impact on Argentina's economy. There were significant capital outflows and in three months, banking deposits went down by 18%. However, rather than abandoning the rules of the game in place, we deepened the economic reforms. We got external financial support to privatize provincial banks and to implement economic reforms in several provinces as well. Therefore, we contained the recessive trend and were able to emerge from the recession after one year.

The economy resumed growth in 1996 and enjoyed another expansionary period that lasted almost three years. One of the consequences of the Tequila Crisis was the increase in unemployment rates. However, between May 1995 and October 1998 unemployment went down from 18.5% to 12.5% of the economic active population due to both renewed economic growth and a reform in the labor legislation.

In April 1991, the IMF had not given its support to the Convertibility Plan and had not granted Argentina a Stand by loan. Three months later, it changed its position and gave a significant support, which by the way was a key factor in implementing the Brady Plan Argentina on Argentinean Debt. Japan followed suit and also gave Argentina its support by means of granting another loan.

In 1994, Argentina had decided to decline the use of the last two disbursements of the Extended Facilities loan that the IMF had granted to support the country's Brady Plan. Notwithstanding, in 1995 the IMF was willing to make those disbursements and provide additional financing in order to ameliorate the consequences of the Tequila effect on our economy. Hence, we were able to demonstrate that a country can achieve a significant adjustment in the Current Account of the Balance of Payments and at the same time, maintain the value of the domestic currency. From 1994 and 1995 the Current Account Deficit was adjusted down by 3% of GDP.

Even though Argentina had a rigid monetary system, its economy was flexible enough to adjust to external shocks. Facing this evidence, the IMF came up with its theory of "two corners" in relation to the exchange rate system. The argument goes: either a clean floating exchange rate system or a strong peg would work, whereas intermediate exchange rate systems are crisis prone.

By 1998, Argentina's Currency Board was so prestigious a system, that I was intensely criticized when I stated that it was a temporary mechanism that should be superseded by a floating exchange rate regime. I am convinced that in 1997 Argentina missed an excellent opportunity to switch from its strong peg to a floating exchange rate system, when there were significant short-term capital inflows. Even in 1999 after the Brazilian devaluation, my proposal to give the Peso limited flexibility by paring it to a basket of foreign currencies was also criticized.

Back then I had this feeling that after eight years in place, our monetary system had made its way into the "Washington Consensus". I must say, however, the story coined at that time, the one that said that Argentina's economic reform was the outcome of applying the "Washington Consensus" recipe, did not make me feel very happy.