

## **Argentina 2002: when the attempt to set “the right prices” destroyed “property rights”**

By Domingo F. Cavallo and Eduardo Cavallo  
New York, September 19<sup>th</sup>, 2002

*“Argentina is condemned to insignificance, probably for ever”  
Hans Tietmayer, 9-17-2002<sup>1</sup>*

*“Argentina’s recovery is under way”  
Joseph Stiglitz, 9-20-2002<sup>2</sup>*

In Argentina, the decade of the 1990s was characterized by the rule of the Convertibility Law.<sup>3</sup> This law secured a right that Argentineans demanded but that had been denied until that moment: the right to use foreign currencies, in particular the US dollar, to protect their savings and to sign medium and long term contracts.

The Convertibility Law was originated as Common Law in a country with Napoleonic Law tradition. Indeed, this law owed its initial popularity to the fact that it ruled according to the already established customs of the people.<sup>4, 5</sup>

It has been highlighted that the Convertibility Law fixed forever an exchange rate of 1 Peso per US Dollar, and therefore it has been frequently described as a “Currency Board”.

We explained in several occasions that the fixing was only temporary.<sup>6</sup> The Convertibility Law set a cap to the exchange rate pesos per dollars but it did not set a

---

<sup>1</sup> See Dier Welt, Germany, 9-16-2002

<sup>2</sup> See El País, Spain, 9-20-2002

<sup>3</sup> From a historical perspective, the 90’s decade in Argentina’s began on April 1st 1991 and ended on December 20<sup>th</sup> 2001

<sup>4</sup> The popularity of this law was demonstrated in every election since its promulgation, including the last one in October 2001. All candidates to senators for the Federal District were asked in a debate about this issue and all of them said that they backed the maintenance of the Convertibility law.

<sup>5</sup> Hernando de Soto, a Peruvian studios of the spontaneous organization of “Pueblos Jovenes” of Peru, concluded that formal legality of underdeveloped countries prevents families operating in the informal sectors to make their contracts worth and to defend their property rights. He recommends the creation of a new legality, one that imitates the spontaneous norms created by these people. In this way, these marginalized communities could start enjoying the benefits of access to credit and the benefits of an economy capable of accruing wealth and growth. In the case of Argentina, allowing the use of foreign currency proved to be the best way to incorporate millions of Argentines who until then, in order to protect themselves from inflation and hyperinflationary chaos, had saved and invested in foreign currency and had been outlawed in the informal sector. See: De Soto, Hernando, “The Mistery of Capital”. Basic Books. New York, USA 2000.

floor. Consequently, the peso could have floated and appreciated at times of strong capital inflows. This characteristic created a natural exit mechanism from the fixed exchange rate regime, without abandoning the convertibility system and, at the same time, maintaining the enforceability of contracts made in foreign currencies.

In fact, in 1997, when Argentina had overcome the Tequila crisis and was growing vigorously, the Peso should have begun to float. At that time, the outcome would have been an appreciation of the domestic currency, and, Congress could have eliminated the ceiling (1 to 1) without introducing any noise. For the astonishment of all of those who confused the convertibility with a fixed exchange rate system, Argentina would have had convertibility with floating exchange rate, as they have it in most advanced economies including Euroland, Canada, Australia, Great Britain and Singapore. The case of Singapore is particularly interesting because it dropped the fixed exchange rate without eliminating the convertibility, precisely through the flotation, at a time that the Singaporean currency needed to appreciate vis-à-vis the Sterling Pound.

Why did not Argentina float in 1997 when that would have eliminated the Damocles' Sword of a traumatic devaluation? The reason is political. By 1997, the rivalry between Menem and Duhalde for the presidential candidacy of the Justicialist Party 1999 had already unraveled. Both decided to use the provincial public expenditure as a tool to win the candidacy. The appreciation of the Peso would have stopped the inflow of short-term capital and, therefore, financing the growing provincial expenditure would have become more difficult. Instead of focusing on consolidating the monetary system that had given back trust to Argentines, the Government facilitated the financing of increasing fiscal deficits in the provinces. This created a problem of excessive and costly indebtedness that made the fixed exchange rate unsustainable and, at the end, destroyed convertibility.

To summarize, the convertibility and not the fixed exchange rate was the important and permanent necessary tool of the Argentinean economy. What was important for the correct functioning of the economy was the freedom of choosing currencies. During the initial phase, the Currency Board that backed all pesos with dollars at a fixed exchange rate was necessary to recuperate people's confidence in the Peso. However, when capital inflows became large, the Currency Board became unnecessary since the Peso could have become a trustable currency due to responsible management of an independent Central Bank. Unfortunately, this opportunity of having convertibility without fixed exchange rate was lost in 1997 and after the Russian and Brazilian crisis it did not resurrect.

However, why regretting on the loss of the convertibility system even if the fixed exchange rate regime could have been successfully abandoned? Why was important for Argentines the use of foreign currencies in medium and long-term contracts? Why not doing what many countries do: force or induce people to save in the national currency?

---

<sup>6</sup> See Cavallo, Domingo in collaboration with Sonia Cavallo “Lessons from the stabilization process in Argentina”. Symposium on Achieving Price Stability- Jackson Hole, Wyoming. Federal Reserve Bank of Kansas City, 1996; also “La Qualite de la Monnaie”. *Economie Internationale*, N. 80- 4 trim 1999- Paris 1999; Cavallo, Domingo Felipe y De Pablo, Juan Carlos, “Pasión Por Crear”. Editorial Planeta. Buenos Aires, Argentina, 2001.

The answer to these questions is the clue to understand what happened and what is happening in the Argentinean economy. It is also clue to understand what has to be done to achieve again sustainable growth in the Argentinean economy.

### **Convertibility and Investment of the Nineties**

The most important effect of the Convertibility Law, in addition to eliminating inflation, was to foster investment increase. For the first time in many years, national savings could be channeled towards investment through the financial system. This did not happen before because saving and lending in foreign currency was forbidden or severely restricted.

When foreign investors realized that Argentines were investing in their own country, they started to evaluate direct and financial investments that were not previously in their plans. This process was encouraged by a deep deregulation of the economy and the privatization of inefficient state owned corporations. The deregulation and the privatization process created investment opportunities for the private sector that until that moment had been monopolized by the government.

<b>Annual Investment per capita</b> (in US dollars at 1995 constant prices)		
Decade	80s	90s
Argentina	1,134	1,421
Brazil	843	909

Source: IMF-IFC CD-ROM. 2002 World Development Indicators CD-ROM, World Bank.

The largest investments were made in the energy, transportation, communications, storage and commercialization, financial services, mining, agriculture and manufacturing sectors. All the indicators of level and quality of services and goods reflected the strong increase in investment. That would not have happened if the Convertibility Law had not protected property rights.

The comparison between the average annual per capita investment in constant 1995 US dollars in Argentina and Brazil demonstrates that the increase in investment was higher in Argentina. In spite of Plan Real, financial intermediation in Brazil continued along the lines of the previous decades and, therefore, there was not significant increase in the availability of domestic and foreign financing for investment.

## Productivity and Growth

The higher output growth experienced in Argentina during the decade of the 1990s is explained not only because investment was higher, but also because productivity increased much more than in previous decades. This difference comes from the fact that the new investment took place in a context of opening the economy to international trade, deregulation and privatizations.

<b>Growth accounting exercise<sup>7</sup></b>		
<b>Argentina</b>	<b>1970 - 1990</b>	<b>1990 - 1998</b>
Average annual GDP growth	0.7	6.3
Average annual capital stock growth <sup>8</sup>	0.9	0.6
Average annual labor force growth <sup>9</sup>	0.9	1.4
Average annual total factor productivity growth <sup>10</sup>	-1.1	4.3
<b>Brazil</b>		
Average annual GDP growth	4.9	2.7
Average annual capital stock growth	1.9	0.8
Average annual labor force growth	2.2	1.3
Average annual total factor productivity growth	0.8	0.6

Source: IMF-IFC CD-ROM. 2002 World Development Indicators CD-ROM, World Bank.

<sup>7</sup> Based on the Solow growth equation:  $\partial Y/Y = \alpha(\partial K/K) + (1-\alpha)(\partial L/L) + (\partial B/B)$ , where  $(\partial Y/Y)$  is output growth,  $(\partial K/K)$  is growth in the capital stock,  $(\partial L/L)$  is growth in the labor stock, and  $(\partial B/B)$  is total factor productivity growth. “ $\alpha$ ” is the factor share income for capital and it is assumed to be equal to 1/3. The methodology follows closely: Jones, Charles I. (1998) “Introduction to Economic Growth”. W.W.Norton & Company, Ins. New York. USA.

<sup>8</sup> Weighted by  $\alpha=1/3$

<sup>9</sup> Weighted by  $1-\alpha=2/3$

<sup>10</sup> Solow Residual.

The table above shows that, during the 1990s, productivity growth turned positive, and significantly so, in Argentina. On the other hand, in Brazil, during the 1990s productivity growth was lower than for the average of the previous decades. These figures suggest that the key to explain economic growth in Argentina during the 1990s is the growth in total factor productivity.

The opening of the economy would have been not possible without the credit expansion allowed by the Convertibility. Without such credit increase, the agriculture and manufacturing sectors could not have invested in new capital and technologies and without these investments, the competition with foreign economies would have been impossible.

Privatizations were possible since medium and long-term contracts could be signed in foreign currency. With the long inflationary experience of Argentina and with so many distortions created by the combination of indexation and price controls it would have been impossible to sign concession contracts with 30 years terms without the Convertibility Law. The deregulation that eliminated restrictions to competition was possible only in a context of price stability. Under high inflation, the competition would have been more than imperfect and many markets could not have been created. Convertibility was crucial to restore stability after the hyperinflation process of the late 80s.

<b>GDP and Exports by decades</b>		
Decade	80s	90s
Average annual GDP growth rates (Constant prices)		
Argentina	-1.5	4.6
Brazil	1.5	2.7
Average annual Export growth rates (Current US\$)		
Argentina	4.4	7.9
Brazil	4.5	5.8

Source: IMF- IFC CD-ROM. 2002 World Development Indicators CD-ROM, World Bank.

In summary, the increases in investment, as well as productivity growth were a consequence of the convertibility system, and investment and productivity growth explain why Argentina’s economy performed so well in the past decade. The table above compares GDP growth and export performance during the 1990s in Brazil and Argentina.

---

Evidently, the 1990s was not an insignificant decade for the Argentine economy; it was a decade that marked a tendency reversal from the historic trend in terms of the behavior of key economic indicators, such as GDP growth and export performance.

### **The causes of the recession that started in mid '98**

Inflation was eliminated and the Argentine economy grew fast during the 1990s. However, the economy entered into a recession by mid 1998, and since then, it has not found its way out. Is the convertibility system responsible for this recession? The answer to this question requires an analysis of the relationship between convertibility, fixed exchange rate and fiscal deficit.

The recession that started in 1998 had its origin in the significant expansion of provincial expenditures that was financed by local banks. This policy characterized the 1997- 1998 period when Eduardo Duhalde, current President and then Governor of the Province of Buenos Aires, competed with the former President Carlos Menem for the candidacy of the Justicialist Party for the next presidential election. The huge assistance provided by the banks to the provinces crowded out the credit for the private sector. This phenomenon increased after the Russian crisis when the influx of capitals to the emerging economies started to decrease.

The recession became more severe and less manageable because of the devaluation of the Real in February of 1999 and the sustained depreciation of the Euro between 1999 and the middle of 2001. The fixed exchange rate to the dollar did not allow the peso to depreciate, as it would have happened in a floating exchange rate system. Consequently, a deflationary process, imperative to reestablish long-term equilibrium of the relative prices between exportable and non-tradable goods, was added to the recessive process.

An alternative to soften the deflationary impact of the depreciation of the Euro and the Real would have been to adopt beginning on January 1999 the Dollar-Euro standard instead of the original Dollar standard created by the convertibility. The authority ignored this possibility by that time in a similar way in which they ignored the possibility of floating by 1997. Only two years after, in March of 2001, the Ministry of Economy proposed and obtained the approval from Congress to change from the Dollar standard to the Dollar-Euro standard. However, the economy had already suffered the deflationary effects of the strong devaluation of the Real.

In summary, the fiscal deficit originated in the expansion of the provincial expenditure and the fixed exchange rate between the peso and the dollar explains the recession and deflation that the Argentine economy has suffered since mid 1998. Was the abandonment of the convertibility necessary to get out of the recession? Our answer is no. On the contrary, we believe that abandoning the convertibility to end the recession was like demolishing a house to unblock a pipe. What had to be done was to find a way to eliminate the fiscal deficit and correct the relative prices without affecting the protection that the convertibility offered to the property rights of savers and investors.

The elimination of the fiscal deficit required the reduction of salaries in the public sector jointly with a restructuring of the public debt that would imply a strong reduction in interest payments, especially at the provincial level. With convertibility, and consequently, without destroying the system of financial intermediation based on foreign currency, it was easier to obtain the reduction in salaries in the public sector and the interest payments, because the maintenance of a monetary and institutional stability, would have allowed an ordered management of both processes.

In fact, the Congress passed a law that allowed the reduction of nominal salaries in the public sector and, if convertibility had not been abandoned, the Supreme Court would have backed these decisions, in a similar way as it did with other salary reductions decided in previous years. The banks, pension funds and local holders of Argentine bonds responded positively to the proposal to exchange for guaranteed loans (with lower interest rates and longer terms) the old bonds. This exchange allowed the restructuring of US\$ 55 billion of public debt and saved 4 billion of interest per year. This shows that with convertibility it could have been possible to finish an ordered process of debt restructuring. In fact, the exchange of bonds for guaranteed loans gave the government the voting power necessary to impose the so called “exit consent clauses” on the old bond contracts to discourage the non participation in the coming exchange of bonds held by foreigners.

The correction of the distortion in relative prices could have been obtained by persevering in the elimination of distorting taxes, insisting with the Dollar-Euro standard and progressively moving towards flotation once the debt had been restructured and the fiscal deficit eliminated. These circumstances would have existed by the beginning of 2002 if the institutional coup of December 20, 2001 had not occurred.

The destruction of the convertibility by the combination of devaluation, generalized reprogramming of deposits in the financial system, pesification of contracts, default of the internal debt already restructured and ulterior flotation of the peso implied the demolition of the institutional and contractual base of the economy and a generalized violation of property rights. Far from facilitating the fiscal balance, it made it more difficult to achieve due to the pressure towards the increase of public expenditure originated in the devaluation and the additional fall of economic activity that followed the collapse of domestic demand.

Prices of exportable goods went up and relative prices reversed, the exchange rate misalignment was larger than before, but in the opposite direction. The credit crunch and the difficulties for importing goods did not allow a positive response of exports. Import substitution was encouraged by the large devaluation but it could turn out to be inefficient and unsustainable under normal conditions. Simultaneously, the fall of domestic demand has been so large that the outcome is a deepening of the recession never seen before in Argentina’s history.

## **The political discussion on unemployment and poverty**

In the years that followed the implementation of the convertibility system, Argentina's GDP grew by more than 10 per cent per year. Statistics showed a substantial reduction in the unemployment rate. Furthermore, the significant fall in the inflation rate contributed to a sharp decline in poverty. However, these trends started to change in 1993 and 1995 for unemployment and poverty respectively. Since then, both problems have shown a firm tendency to grow.

The discussion about which strategy had to be developed to address these problems extended all through the 1990s. Those of us who were persuaded that the opening and deregulation of the economy, the privatization policies, and the protection of property rights were the best instruments to ensure sustainable economic growth, insisted that labor, tax and welfare system reforms were necessary. This was key to allow the growth in GDP to continue while allowing a reduction in the rate of unemployment and poverty. As far as labor deregulation is concerned, we insisted to have more flexible employment contracts. Regarding taxation, we proposed and started to eliminate payroll taxes and other distorting taxes. Regarding the welfare system, we demanded that provincial governments should conduct social policies in a less biased and more efficient way, especially in the fields of education, health care and social aid.

However, some other national leaders started to lobby for a “change of rules” referring to the economic reforms implemented in Argentina throughout the 1990s as “the neoliberal model”. According to them, such policies had triggered the rise in unemployment and poverty. Consequently, only “changing the neo-liberal model” could reverse the negative trends of the last half of 1990s. That meant, by destroying the economic reforms. The Convertibility Law was seen as the epitome of “neo-liberal reforms” and it had to be revoked. The strongest advocates of this idea were Eduardo Duhalde (Justicialist Party) and Raúl Alfonsín (Radical Party). Neither Alfonsín nor Duhalde had won in the election process in which they proposed the abandonment of the convertibility. Still, they thought that the evolution of economic and social events during 2001 proved them to be right. Therefore, when Duhalde came into office with Alfonsín's support, he was convinced that he had been appointed by the circumstances to repeal the Convertibility Law and to “change the neoliberal model”. They both expected that this would bring down unemployment and poverty rates.

## **The professional discussion about the public debt and the currency regime**

While the political arena showed different standpoints regarding the diagnosis of the problem and the strategy to fight unemployment and poverty, professional economists discussed about the sustainability of the public debt and the currency board system. The strongly opposing views about these issues could be divided into two distinct groups. On the one hand, there were those who supported dollarization arguing that, if the US dollar were adopted as the national currency, the fiscal discipline would be enough to ensure the payment of the debt. On the other hand, there were those who recommended

floating the currency and who were persuaded that Argentina should default on its debt and restructure it compulsively. The former group emphasized that by maintaining monetary stability and servicing the debt, confidence would be regained and interest rates would decrease, enabling the economy to recover. The latter group considered that unless relative prices of tradable goods increased, the economy would continue to be stagnated and the country would no longer be able to serve its debt.

Even though we shared most of the views held by those who proposed the flotation of the peso, we were also persuaded, as the dollarization supporters, that if property rights of those who trusted in the country and saved locally were severely affected by a devaluation, economic growth would not resume, no matter how rapidly and firmly were relative prices adjusted in favor of exports. For that reason, we tried to find a balance between both positions. We tried to apply all possible non-monetary resources to correct relative prices, without violating convertibility. Regarding the exchange rate regime, the plan was to move into a more flexible system once fiscal balance had been achieved by the reduction of interests obtained after restructuring the debt in an ordered manner.

Instead of forcing a change in the currency in which the contracts were signed, either towards dollarization or pesification, the government had the intention of respecting people’s freedom to choose between the Argentine peso and the US dollar for their transactions. Unfortunately, this idea lacked an adequate professional support, possibly because both pesification and dollarization advocates were focused mainly on a debate about the exchange rate regime –currency board system versus floating exchange rate system- rather than on the monetary regime and the protection of property rights. The Convertibility Law had provided for the monetary system that people demanded and it was perfectly compatible with the two different exchange rate regimes or even with any other intermediate alternative, but only if the proper fiscal conditions were met.

### **An unfortunate tactical coincidence**

On November 1<sup>st</sup> 2001, we announced the two-phase restructuring scheme for the public debt. Since that moment an unfortunate tactical coincidence originated by the political leaders who wanted to “change the economic model” and the economists and entrepreneurs who favored a devaluation. Some of the major media groups subscribed to the ideas of this virtual “tactical alliance”, since they thought that abandoning “the convertibility model” through devaluation would be a way of reducing their excessive indebtedness. Such strategic coalition tried to gather support from both public and private debtors. After all, they would all end in simultaneous and generalized default, which would lead to a substantial reduction in the real value of debts.

However, the national leaders, economists and entrepreneurs who supported the tactical alliance failed to see that creditors were not just “foreign financial investors” but actually millions of savers who had trusted in the Argentine financial system and millions of workers who contribute to the pension system for their future retirement. Measures such as compulsorily rescheduling of all deposits, the pesification of contracts originally

written in US dollars, the devaluation and subsequent floatation of the peso, would drastically affect property rights and discourage practically all investments and the purchase of durable goods; furthermore they would create a sense of legal uncertainty, that would lead to a virtual paralysis of the financial system and consequently to the saving and investment mechanism.

### **A further rise in unemployment and poverty**

The measures carried out by Eduardo Duhalde's administration -supported by Raúl Alfonsín<sup>11</sup>- since January 2002 have extremely exacerbated the recession. Furthermore, they have created skepticism about the chances of any economic recovery. This is the reason why unemployment and poverty have risen so critically. Could this situation have been predicted?

It certainly could. For that reason, those of us who were in charge of governing the country spent all the year 2001 struggling to avoid the default on the debt and the devaluation of the peso<sup>12</sup>. However, was there any better alternative than the one eventually applied? Was not the default and currency crisis inevitable for Argentina? Furthermore, had not this already occurred when the bank curb was implemented on December 1, 2001?

The alternative was to continue eliminating the fiscal deficit, by forcing the provinces to reduce salaries in the same way that the Federal Government did in July 2001 and by cutting interest payment on public debt and by deferring capital maturity dates. These conditions would be achieved after carrying out an ordered debt-restructuring process, like the one launched on November 1, 2001. This alternative certainly implied some degree of compulsiveness and rescheduling plans, the reduction of financial repayments, and the flexibility regarding the change from pesos to US dollars. However, both processes needed to be implemented in an ordered way to have the lowest possible impact on the property rights of savers, investors and workers.

To halt the critical run on the financial system, some temporary restrictions –which became known as *corralito*- had to be implemented on December 1, 2001. This implied only a temporary control on transactions in foreign currencies, similar to the ones imposed by several countries between 1870 and 1930 via a measure called “suspension of convertibility”. The *corralito* was a mere curb on cash withdrawals and financial transfers abroad. In fact, deposits did not lose their value and savers could use their funds to make payments within the country via debit cards, checks and inter account bank transfers. Furthermore, these methods of payment actually helped to improve tax administration. Far from aiming at a default on the debt or the termination of

---

<sup>11</sup> For a description of the origin of Eduardo Duhalde's government, see “An Institutional Coup”, by Domingo F. Cavallo, at [www.cavallo.com.ar](http://www.cavallo.com.ar)

<sup>12</sup> For a description of this situation, see “The Fight to Avoid Default and Devaluation”, by Domingo F. Cavallo, at [www.cavallo.com.ar](http://www.cavallo.com.ar)

convertibility as the system which enabled the free choice of currency, the corralito focused on preserving the value and availability of savings while the public debt restructuring process and the national and provincial fiscal re-adjustment plans were implemented.

Why did Eduardo Duhalde’s administration, backed by Raúl Alfonsín, take such a wrong path? My answer is that the professional discussion among the economists and the lobby of heavily indebted media groups misled them to such an extent that they truly believed that they were implementing “the change” that would lead to recovery of the economy, and would ease poverty and unemployment. In this paper, I would like to emphasize the role of professional economists as contributors to the confusion of national leaders.

### **“Right Prices” versus “Property rights”**

Those who pointed out the recessive effects caused by the divergence between the prices of tradable goods and non tradable ones recommended the replacement of the currency board regime by a free floating system. They thought that by setting prices rightly, the economy would recover through an increase in the production of exportable goods and the substitution of import<sup>13</sup>. However, they did not realize that the adjustment of relative prices via the destruction of the convertibility system that would affect property rights in such a way that medium and long-term contracts would become highly unfeasible and saving inside the country as well as investment would almost disappear.

At the same time, those who supported the defense of savers and financial investors’ property rights would be critical with any government action tending to correct relative prices without abandoning convertibility.<sup>14</sup> In this context, it is understandable that national leaders like Duhalde and Alfonsín, who had always favored a “change of the neo-liberal economic model”, considered that this was a good moment to reverse the economic reforms applied.

### **The future**

The end of the convertibility ended with the free selection of currency and with the system that assured the respect of the currency in which contracts were originally denominated on. The change of conditions will discourage investment and productivity, two key factors for sustainable growth. Economic recovery through the promotion of exports and import substitution will occur only if new large investments are not needed, since they will be very difficult to fund. Additionally, it will take too long before an increase in the production of exportable goods and the substitution of imports are able to

---

<sup>13</sup> Joseph Stiglitz has recently pointed out in an article that such situation was certainly going to happen. And that it is already happening! See “La recuperación Argentina”, *El País* newspaper; Spain; September 20, 2002.

<sup>14</sup> Consider the arguments of those who praised “dollarization” and criticized convertibility, the inclusion of the euro, and the successive attempts to reschedule debts.

compensate for the dramatic fall of the domestic market caused by the depreciation of people's real income that the devaluation caused.

Such pessimistic forecast could be reversed if the following issues are addressed:

1. The Rule of Law must be restored: the compulsory rescheduling of deposits and the pesification of contracts originally written in US dollars should be overruled. The impact of these two measures on the inflation rate will depend on the Government's reaction vis-à-vis such judicial decisions.
2. A new government must be elected. People must recognize its leadership and must identify it with the protection of their property rights. The new government must commit itself to rebuild the necessary conditions to attract new investment and to foster productivity, as was the case during most of the 90s.
3. Welfare policies must be transformed so that corruption, favoritism and inefficiency are eradicated, and investment in human capital can reach poorer families.

Without any doubt, a challenge for the Argentineans and for their national leaders is formidable.

The Government could take advantage of the opportunity offered by the judicial decisions favorable to depositors' claims to regain gradually savers' confidence and induce them to keep their deposits in the Argentine financial system; this is perfectly possible because their funds would be available for payments within the local banking system. Under these conditions, the peso will steadily appreciate and relative prices will reach equilibrium compatible with the simultaneous recovery of exports and home consumption.

However, if the Government disregard the eventual declaration by the Court that pesification is unconstitutional or fail to convince depositors to keep their funds in the banking system, the Central Bank will have to issue pesos or bonds of all types. These unfavorable circumstances will trigger an uncontrollable inflationary situation. Relative prices will possibly balance at the end of the process, but the inflationary process that will take place, may turn to be long, unpredictable and costly.

Professional economists can help to find a solution. They have to realize that the strategy to promote exports cannot go against property rights of savers, investors and workers. The contribution of economists to Argentina's institutional and moral recovery should be reflected in rules and institutions capable of regaining the balance of relative prices in a way that does not violate property rights. Only within this framework Argentina's economic recovery will have started. We certainly do not share Hans Tietmeyer's utmost pessimism but, at the same time, we think Joseph Stiglitz's optimistic assessment still lacks sound foundations.