An Interpretation of Argentine Economic and Political History: Dutch Disease on the Pampas

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Introduction

At the beginning of the twentieth century, Argentina had the world’s tenth largest trading economy.\textsuperscript{1} By 2005, the country had fallen to 33\textsuperscript{rd}.\textsuperscript{2} The cyclical nature of global finances had had its effect on a nation dependent of primary commodity exports.

In the years following the Great Depression, the agricultural sector, which employed a steadily decreasing percent of the workforce and produced a majority of the country’s exports, brought enough foreign currency into the country to cause an appreciation in the real exchange rate. This led to an economic situation commonly called “The Dutch Disease.”

Different leaders had various responses to inflation and to the dominance of the agricultural industry in Argentina. Gen. Juan Perón’s attempt to establish successful manufacturing industries backfired as he subsidized sectors in which Argentina did not have a comparative advantage and therefore could not compete internationally without government support. The subsidies, continued by various governments to gain support from working class unions, discouraged the movement of labor into industries associated with the commodities boom, further exacerbating the effects of Dutch Disease.

In the following pages, I will trace the ups and downs of the Argentine economy from its colonization by the Spanish to the present day, though I believe the key period that has determined the course of Argentina’s economy for the second half of the twentieth century and the early part of the twenty-first was the first presidency of Perón, from 1946 to 1955. I will elaborate on the division of labor in Argentina and its role in the economy. Ultimately, I hope to prove that the cause of Argentina’s economic
misfortunes was a Dutch Disease induced by the strong performance of the export-based agricultural sector and inflamed by the poor decisions made by multiple governments.

**A Brief History: Colonization through World War II**

From its initial colonization to World War II, Argentina’s development was export driven. Economic improvement centered on the products of the pampas, the majority of which were bought by Europe. As in many countries in Latin America, “tax revenues came primarily from the foreign trade sector, and government expenditures were oriented toward the development of physical infrastructure.” However, the decline in international trade during the Great Depression and the two world wars convinced many Argentines that lasting economic growth could only be achieved if the country moved away from its dependence on the global import-export market.

Initial colonization of Argentina was centered on Buenos Aires and the northwest corner of the country, around Tucumán. The principal achievements of the failed first efforts to colonize Buenos Aires between 1536 and 1541 were the abandonment of cattle and horses on the pampas. Both species flourished and soon the beginnings of the gaucho culture were seen as natives domesticated the horses to hunt the cattle. Although the second Spanish attempt at Buenos Aires in 1580 succeeded, for much of the colonial period, the demographic and economic center of the country remained the northwest, close to the silver mines at Potosí, the second largest city in the Viceroyalty of Peru and the destination of mules, tallow, and leather from the estancias in the pampas.

The mercantilist policies of imperial Spain mandated that all trade with Europe pass through the designated ports of Lima and Callao. Buenos Aires, because of its location, served as a convenient center for smuggling, especially with Britain and France.
The Bourbon Reforms of mid-1700s reorganized the economic and political systems of South America. In an effort to strengthen royal control, and to reap some benefit from the contraband trade passing through the port, Buenos Aires was established as the capital of the new Viceroyalty of the Rio de la Plata. It was now legally allowed to trade directly with Spain. Although the northwest was still the most productive part of the country, Buenos Aires was in ascendance.

The French Revolution and the subsequent wars on the European continent sparked the wars of independence in Spain’s colonies in the New World. The Bourbon king of Spain was deposed in 1806 by invading French forces, and Joseph Bonaparte, the brother of Napoleon, was placed on the thrown.

Seeing an opportunity at imperial expansion at the expense of the new Spanish enemy, a British force returning home from the successful conquest of Cape Town detoured to attack Buenos Aires. The British invasions of 1806 and 1807 put the country on the path to independence. The invaders briefly occupied the city, causing the panicked Viceroy to flee into the pampas. Independent of Spanish government support, the local inhabitants, under the leadership of the French-born Santiago de Liniers, defeated both the initial invaders and the much larger reinforcement expedition a year later. These two victories were instrumental in giving the Argentines enough self-confidence to declare independence from Spain.

Meanwhile, across Spain’s possessions in the New World, various factions either declared their allegiance to the deposed Bourbon king, the new Bonaparte monarch, or declared their independence. In 1810, at the Congreso de Tucumán, the Viceroyalty of the Rio de la Plata separated from Spain. Initially, the city of Buenos Aires sought to
maintain the integrity of the Viceroyalty, but failed to prevent the separation of Paraguay and Uruguay. Even many of the provinces threatened to leave the union which Buenos Aires sought to control. This conflict between Buenos Aires and the interior would continue until the mid-1800s.

Spanish power in South America ended in 1824. Although Argentina was independent, it required several strong rulers through the mid 1800s to solidify the identity of the country. Through 1862, the country was divided between two factions. On one side was Buenos Aires, which wanted all trade to pass though its harbor. On the other were the provinces, which resented Buenos Aires’ monopoly on foreign trade and wanted unrestricted access to overseas markets. At the height of the conflict, Buenos Aires separated from the rest of the country. From 1852 until Buenos Aires rejoined the republic in 1862, Argentina was two separate countries.

With the reentry of Buenos Aires, the main source of revenue for the country, Argentina entered a new era of growth. As settlement of the pampas expanded, wool and cereal production replaced the old colonial commodities of hides and tallow as the nation’s principal exports. Good economic conditions and labor shortages led to an influx of immigrant Europeans, especially from Italy and Spain. The population grew from two million in 1869 to eight million in 1914, and in 1914, the census showed that seventy percent of the working class of Buenos Aires was foreign born. Some of these new arrivals moved out to the frontier. However, increased settlement of the pampas invited increased raids from Indians in Patagonia. Both to protect its borders and to allay the fears of would be immigrants, in 1878, General and later President Roca initiated his
“Conquest of the Desert,” a conquest/extermination that effectively eliminated Indian resistance in the country.  

Improved technology, especially the invention of refrigerated shipping in the 1870s, made Argentina a leading exporter of beef, although other commodities like corn and wheat continued to be exported on a large scale. The late 19th and early 20th centuries were the belle époque of Argentina, with the economy growing at an annual rate of 3.7 percent. As can be evidenced in the table below, the GDP per capita rose substantially between 1850 and 1913. Although its GDP per capita was only about half that of the U.S., it compared favorably with Canada, and Argentine citizens were economically better off than their neighbors in Chile and Brazil.

| Historical per Capita Growth of GDP (per capita in 1985 U.S. $) 
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The restrictions on foreign trade during the First World War and its immediate aftermath slowed the economy to an annual growth rate of -0.1 percent, although there was a “sharp upswing” in the middle of the period. The economy recovered, and by the twenties, “Argentina continued with export-led growth based on extensive agriculture that in part involved bringing new land into production.” In 1929, on the eve of the Great Depression, merchandise exports composed more than twenty-five percent of the
GDP. In comparison, in 1929, merchandise exports composed fifteen percent of the GDPs of the U.K. and Germany and slightly less in France. Only about ten percent of Argentine exports went to the U.S. The biggest buyers were in Europe, especially the U.K., which purchased 32.3 percent of Argentina’s exports, while France and Germany combined purchased 17 percent.

With such a heavy reliance on exports, the drop in the prices of primary commodities during the Great Depression, combined with the protectionist policies of Argentina’s principal customers, shocked the economy. The economic isolationism of the great consumers, exemplified by the American Smoot-Hawley Tariff of 1930, worsened the global situation and convinced many Argentines that heavy involvement with the world economy would only result in economic ruin.

The Argentine government responded to the situation with a moderate increase in tariffs and imposed foreign exchange restrictions “in response to balance of payments problems.” Although at this point the Argentine government was still attempting to maintain a balanced budget, its monetary policy was more active than many other Latin American countries. The real money supply increased from 99.6 in 1928 to 109.8 in 1934 to 108.3 in 1939. At the same time, the real exchange rate depreciated, from 1.00 in 1929, to 1.50 in 1934, to 1.43 in 1939. As a result, “the prices of importables and nontradeables increased relative to those of exportables.” This increase was the result of government policy, and served to protect an expanding industrial sector. As a consequence, the Argentine GDP grew at an average rate of 2.5 percent during the period of 1931-1940.
The outbreak of World War II added political concerns to the economic equation. As part of its war effort, the U.S. attempted to secure the support of the South American countries. Although Brazil sided with America, and even sent soldiers to fight in Italy, Argentina, ever suspicious of the expansion of Yankee influence in South America, rebuffed diplomatic overtures and instead signed arms deals with Nazi Germany. Although many citizens of the country were sympathetic to the Allies, the Argentine government’s failure to declare war on Germany until 1945 combined with the Army’s friendship and admiration for the German Army led many in the American government to believe that Argentina was pro-Nazi. The U.S. responded negatively, preventing countries from using Marshall Plan dollars to buy Argentine products. This would not be the last time Argentina’s politics would harm the economy.

**The Dutch Disease**

That was the situation in Argentina in the immediate aftermath of the Second World War. What followed was Perón’s attempt to continue to improve the economic well-being of the country by formalizing the expansion of ISI (that had, in effect, begun during the de facto protection of the Great Depression and World War II) and thus removing Argentina from the cyclical nature of the global marketplace. However, Perón’s approach was incorrect because it failed to address the true problem: the Dutch Disease.

The Dutch Disease is a situation in which a booming export section employing a small percentage of the workforce hampers other parts of a nation’s overall economy. In a textbook case, “booming primary exports, by stimulating more rapid domestic inflation
and thus causing the real exchange rate to appreciate, render *other* exports less competitive and hence less profitable."

An influx of foreign currency from the chief export causes the value of the local currency to increase relative to other currencies. At the same time, higher incomes of those associated with the boom cause inflation as demand and prices increase for nontradable goods. This causes the real exchange rate to appreciate, making other tradable goods produced in the country less competitive in international and domestic markets. (A tradeable good is something a country produces that can be exported or imported while a nontradeable is a good produced domestically as is not imported or exported, like utilities and many services). While production of nontradables grows due to increased demand, the workers of less competitive tradable industries, who greatly outnumber the workers from the boom sector, are faced with rising prices and need higher incomes to survive. Their employers, however, cannot raise wages (which would necessitate raising prices) and be competitive. Reduced profits from the appreciating exchange rate will “cause some of them to reduce production and employment.” Thus, “the boom in primary exports and nontradables is partly offset by a depression in the other tradable industries.”

The Dutch Disease got its name from the experiences of the Netherlands in the 1960s and ‘70s after reserves of natural gas were discovered and the country received a large influx of foreign exchange. Other countries have had similar experiences. Nigeria’s is typical. Oil was discovered there in 1956, but the industry only employed a fraction of the population. In 1975, only 0.4 percent of the labor force worked in the petroleum sector. The OPEC oil embargo in the early 1970s quadrupled the price of
petroleum, and it doubled again between 1979 and 1980. As a result, the Nigerian nonmining GDP rose twenty-three percent.

The government took advantage of this increase in funds, and “public investment rose from 4 to 30 percent of nonmining GDP and the average pay for civil servants was doubled in 1975.” However, with much of the new money wasted on useless projects, the Nigerian government ran an average budget deficit of twelve percent of the GDP from 1981 to 1984. Even with the increase in consumer spending, the central bank decided to maintain the nominal exchange rate, and, as a result, the real exchange rate tripled from 1971 to 1984. This caused the nonoil exports of Nigeria to drop ninety percent. Throughout all this, a politically weak agricultural sector was ignored while other sectors were developed. From 1973 to 1984, agricultural exports fell by two thirds. Due to the decrease in nonoil exports, Nigerian growth during the 1972-1981 period was sixty percent of what it had been before the boom.

Nigeria’s experience is different than Argentina’s in a key aspect: in Nigeria, as in many oil-producing countries, the agriculture sector was a victim of Dutch Disease; in Argentina, the cause of Dutch Disease was the high volume of foreign currency brought in by the booming, export-oriented agriculture sector.

There are ways to beat the Dutch Disease. Pursing anti-inflationary policies, such as devaluing the currency, cutting back on government spending, or devaluing the exchange rate, can help mitigate the need for less competitive exporting industries to cut production, and “if it is relatively easy to move capital and labor between the booming commodity sector and other activities and if the booming sector can employ all the
factors of production released from other, less-profitable activities, then the commodity boom poses no major problem.”

During much of the twentieth century, the governments of Argentina did not pursue anti-inflationary policies (they pursued inflationary ones), and during the second half of the twentieth century, the agricultural industry, the boom sector, went from employing 26 percent of the workforce in 1950 to just 13 percent in 1980. As will be elaborated upon later, workers in the agricultural sector lived in the rural, less developed areas of the country. The unattractiveness of sub-par living conditions, mechanization, and Peronist industrial subsidies served to prevent the movement of workers from city jobs to agriculture. City jobs were in protected industries, and the workers there were being paid more than they had in the past. The increased spending from this industrial class served to increase inflation, the opposite of what was required to cure Dutch Disease.

**The Rise of Perónism**

Riding a wave of popular support, Juan Domingo Perón was elected president in 1946 and, in part to appease his power base in the unions, instituted a formal policy of ISI. Import substitution industrialization was the government policy of instituting high tariffs and quota systems to protect state-owned industries from foreign competition while also granting those industries tax and credit incentives. The belief was that after these state-owned businesses had reached a certain level of productivity they would no longer need tariffs and subsidies in order to compete with foreign industry. However, taking advantage of the rising prices of agricultural commodities in the aftermath of World War II, the government funded ISI by taxing agricultural exports,
“which neutralized any beneficial effect that the new terms of trade might have had on domestic agricultural prices. In addition, high tariffs and restrictions on imports were imposed to protect domestic producers from foreign competition. The net result was that agriculture stagnated while the import substitution industry grew rapidly. The scene was set for the ‘stop-go’ performance that…characterized Argentina’s economy for the next four decades.”

The economic conditions of the 1930s contributed to the beginning of the internal migration of many people from the countryside and smaller provincial towns to the cities, especially Buenos Aires, where there were greater opportunities for work. During the Perónist Era and beyond, the percentage of the labor force employed in agriculture dropped from twenty-six percent in 1950 to thirteen percent in 1980.

It was not only the prospect of work that drove people from jobs in the agriculture sector. The quality of life in rural areas was significantly less than in urban centers. Even by the year 2000, only thirty percent of the population living in rural areas had access to improved drinking water sources, and only forty-eight percent had access to improved sanitation facilities. In comparison, in 2000, eighty-five percent of the urban population had access to improved drinking water sources and eighty-nine percent had access to improved sanitation facilities.

Intensification of existing farmland also served to decrease the number of people employed in agriculture. An excess of land and a lack of labor had always been the lot of the Argentine agriculturalist, and this led to induced innovation. Farmers were forced, by lack of labor, to mechanize their operations as soon as was technologically possible. However, during the second half of the twentieth century:
“to compensate in part for the reduced relative prices of agricultural outputs, the government subsidized some of the inputs used in agricultural production. Specifically, it made credit available at subsidized rates of interest, offered tax exemptions for the purchase of farm machinery, and provided financial support for technological research.”

As a result, from 1979, the first year for which data is available, to 2001, the number of tractors per sq. km of arable land rose from 0.6 to 0.9. More significantly, the amount of fertilizer consumption rose from 46 hundred grams of nutrient per hectare in 1979 to 330 hundred grams of nutrient per hectare in 1998.

Regardless of the migration of labor, and “although agriculture had been overshadowed significantly by industry since the end of World War II, [the agriculture sector] nonetheless contributed substantially to Argentina’s GDP.” From 1961-1985, agricultural exports composed more than fifty percent of Argentina’s exports. Between 1981 and 1985, the agriculture sector made up 11.2 percent of the national GDP while employing 13 percent of the labor force. Despite Perón’s emphasis on industry, the agriculture industry still supplied the majority of the country’s exports.

In 1945, during Perón’s stint as Labor Minister, the Law of Professional Associations was passed. This law established an umbrella union, the Confederación General de Trabajo (CGT), which would be the voice of all unions to the government. With government support, unions expanded rapidly. In 1943, only about twenty percent of the urban labor force was unionized. Union membership increased from 520,000 members in 1946 to 2,334,000 in 1951. Perón recognized the potential power of the
unions and supported laws that led to their expansion, and they in turn supported his rise to the top.65

These previously unaffiliated new arrivals from the rural areas were ready recruits for Perónist labor unions.66 While some found employment in the expanding industrial sector (which increased in size from 435,816 workers in 1935 to 1,056,673 workers in 1946), others became the newest residents of the ever increasing number of villas misería, the slums in Greater Buenos Aires.67 The poor circumstances of many Argentines only increased union members support for Perón. Indeed, “almost anyone inquiring of a Perónist worker why he supported Perón [was] met by the significant gesture of tapping the back pocket where the money is kept, symbolizing a basic class pragmatism of monetary needs and their satisfaction.”68

Coinciding with the increased unionization was the release in 1950 of Raúl Prebisch’s *The Economic Development of Latin America and its Principal Problems* for the Economic Commission for Latin America (known by the acronym formed from its Spanish name, CEPAL). Prebisch’s theory explained the world economy as a relationship between ‘core’ and ‘periphery’ countries.69 The condition of the economies of periphery countries depended on the condition of the core countries’ economies, and the relationship was typically explained with graphs showing cyclical performances, with the peaks and valleys of periphery countries more exaggerated than those of the core. Prebisch believed that periphery countries could free themselves from their cyclical ties to core countries by developing their own manufacturing sector to supply their own domestic market, removing the need to rely on the international market for economic well-being.70
Prebisch’s ideas found a ready audience in an Argentine populace whose memories of the Great Depression were still fresh.\textsuperscript{71} As president of Argentina, Perón’s industrialization policies, articulated in his first five year plan, enacted enough trade barriers to effectively eliminate competition from imports.\textsuperscript{72} The barriers were effective. The value of imports of goods and services as a percentage of GDP fell from twelve percent in 1938, to eleven percent in 1948, to six percent in 1958.\textsuperscript{73} Although Perón’s plans ensured support from the working class, they were not sound economic policy. By supporting domestic industry through tariff protection, Perón prevented the movement of labor between competitive and noncompetitive businesses. Workers lacked the incentive to move from one industry to another. Instead of saving government surpluses from taxes on agricultural exports, Perón spent excess funds on welfare projects and other programs to help laborers and the industries they worked for, whose effective monopolies on domestic markets provided customers with an often more expensive and inferior product. He did, however, buy political support.

As long as primary commodity prices remained high, the Argentine government was able to use taxes on primary commodity exports to fund its programs. Indeed, the GDP per capita grew 2.3 percent from 1941-1949.\textsuperscript{74} However, a drought in the early fifties hurt agricultural production and decreased government revenues.\textsuperscript{75} After years of growth-inhibiting taxes, Perón attempted to revitalize the agricultural export section with his second 5 year plan in 1952. These new policies, which were implemented shortly after the death of Eva Perón, included “wage controls, partial price deregulation, encouraged foreign investment and the promotion of traditional [agricultural] exports,” and conflicted with his earlier policies.\textsuperscript{76} The new policies alienated his many of his
supporters, and ultimately, the military led a coup in 1955 that removed him from power.77

Alternating military and civilian governments proved unwilling, for reasons of nationalism, radicalism, or personal benefit, to dismantle the large state-owned apparatus of industries.78 Instead of long term solutions, political and military governments throughout the ‘60s, ‘70s, and ‘80s, concerned with maintaining power, tried to achieve, in the short-run, the objectives of price stability and deficit-reduction.79 Rather than lower export taxes and increase agricultural exports, successive governments saw export taxes on “the products of the pampas…to be an excellent way of dealing with those two problems in the short run.”80 Governments liked export taxes because they were quick and easy to collect, in marked contrast to the taxes brought in by the inefficient national tax collection system, which ran chronic deficits.81

The rise of commodity prices in the aftermath of the first oil shock in the early 1970s led to a windfall in revenue from export taxes on agriculture.82 This in turn led to a fifty percent increase in government expenditure from 1972 to 1975.83 However, the boom ended in 1975, and with the inefficient tax system unable to keep pace with demand, the government increased the money supply to cover budget deficits (a process called seignorage).84 It rose at an annual rate of growth of 154.2 percent in 1982 to 582.3 percent in 1984 to 4,168.2 percent in 1989. Easy loans from international banks awash in oil money encouraged governments, both civilian and military, to increase public debt, both to cover the budget deficit and to pay interest on other loans. From 1976 to 1982, the debt-to-GDP ratio went from nineteen to sixty percent.
A national debt of $42,000 million was inherited by Raul Alfonsín, the first democratically elected president after the military dictatorships of the ‘Dirty War.’ Concerned with healing civil society and preventing the return of the military, the administration of Alfonsín, “in an attempt to buy support from voters, organized labor, and business … ran a loose, populist monetary policy.” However, inflation, which rose from 164.8 percent in 1982 to 672.5 percent in 1985, necessitated a change.

In June of 1985, the Alfonsín government launched the Plan Austral. This plan was conceived as a “war on inflation.” A new currency, the austral, was introduced and wages and prices were frozen, and the government promised to limit the use of seignorage. The new plan, however, continued to favor industry over agriculture. The Alfonsín government continued to tax exports as a main source of revenue.

Initially, the Plan Austral worked. Inflation dropped from over 600 percent in 1985 to 85.7 percent in 1986. The growth rate of the money supply also dropped, from 584.3 percent in 1985 to 89.7 percent in 1986. However, investment failed to increase and the government did not ease price and wage controls as promised. An overvalued exchange rate hurt the balance of trade, and consumer confidence in the plan was undermined. Tax revenues fell, and urban unemployment rose from 3.9 percent in 1984 to 7.6 percent in 1989. The government was force to increase borrowing, at higher interest rates, to cover budget deficits and maintain the exchange rate, and by 1989, the central bank had exhausted its reserves trying to defend the strength of the currency. Seignorage was reintroduced, and the money supply rose from 89.7 percent in 1986 to 4,168.2 percent in 1989. The austral went into free fall, with the inflation rate passing 3,000 in 1989.
Needless to say, Alfonsín did not win the 1989 presidential election. Victory went to a Perónist provincial governor named Carlos Saul Menem, who confounded expectations of a return to Perónist policies and instead ushered in a decade of growth.

**Structural Adjustment and Financial Meltdown**

Menem confounded expectations of a continuation of state ownership and instead privatized state companies. This caused rising unemployment as the new owners restructured businesses to make them more profitable.¹⁰⁰ Coinciding with privatization was the implementation of the Convertibility Plan. This plan was the creation of Domingo Cavallo, the finance minister, and it pegged the peso to the dollar, bringing inflation under control by limiting the number of pesos the government could print.¹⁰¹ There followed a decade of economic growth.¹⁰²

However, economic crises in other parts of the world and the rising domestic debt, which had ballooned under Menem, eventually put pressure on the Argentine government to abandon the Convertibility Plan, sending the country into the financial crisis of 2001 and 2002 that saw five presidents in ten days.¹⁰³

Menem’s privatization plans were in line with the policies of the Washington Consensus. These policies, which were championed by the International Monetary Fund (IMF) encouraged “fiscal discipline, a redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure, tax reform, interest rate liberalization, a competitive exchange rate, trade liberalization, liberalization of inflows of foreign direct investment, privatization, deregulation (to abolish barriers to entry and exit), and secure property rights.”¹⁰⁴
The hyperinflation of the eighties drove the Argentine government to abandon state ownership and accept the Washington Consensus.\textsuperscript{105} As part of his reformation of the Argentine economic system, Menem supported Cavallo’s Convertibility Plan. By effectively removing the government’s ability to print more money, Menem and Cavallo were removing a major source of inflation.\textsuperscript{106} Indeed, inflation fell from over three thousand percent in 1990 to less than one percent from 1996 to 1998.\textsuperscript{107}

The one to one convertibility plan stabilized prices, which, in conjunction with the removal of price controls, the privatization of many previously state-owned companies, and the lowering of tariffs helped spark a boom of increased investment in the economy, both from within the country and without.\textsuperscript{108} Foreign firms like J.P. Morgan and Merrill Lynch bought millions of dollars worth of Argentine bonds.\textsuperscript{109} Domestic banks were also major customers, and bought government bonds with the savings of their depositors.

Investment was focused in the primary sectors of the national infrastructure (like energy and telecommunications) as well as certain manufacturing industries such as automobiles and household appliances.\textsuperscript{110} With the exception of 1995, during the Tequila Crisis, the national GDP grew at a rate of around six percent for most of the nineties.\textsuperscript{111}

Despite the growth of the economy, the government failed to adequately address two key problems: the funding of the pension system and spending by provincial governments. Due to the privatization of public industries, which transferred workers from public pension plans to private ones, and the “pay-as-you go nature of the state pension scheme,” “disbursements to existing pensioners could no longer be funded out of contributions by those who work,” and had to covered by the government, in part by selling bonds.\textsuperscript{112}
The second problem was the excessive spending by the provincial governments. Over time, the conflict between the provinces and Buenos Aires produced a tax system in which “the federal government is largely responsible for raising taxes while the provinces function as spending machines.” Uncontrolled spending by the provinces increased the national deficit which the federal government was forced to cover by going deeper into debt.

The problems with the public finance system were compounded by the corruption of Menem and his successor, Fernando De la Rua. Some of the money borrowed by the Argentine government during this period was used by Menem to purchase political support through the financing of projects that benefited his supporters. De la Rua’s party, the UCR, was involved in a scandal involving the bribery of opposition senators for congressional votes.

Interest rates for government loans remained high throughout the Convertibility period, ensuring that borrowing continued to be expensive for the government. The high interest rates were caused in large part by the culture of political corruption. According to Colin Lewis, a Senior Lecturer at the London School of Economics and author of *Argentina: A Short History*, corruption in the political class “raised the cost of doing business in Argentina and undermined confidence in the political sustainability of the [Convertibility Plan].”

Problems came to a head with the economic crisis in Brazil in 1999, when Brazil was forced to devalue its currency. Brazil was one the largest purchasers of Argentine exports, buying nearly a third of all products shipped overseas in 1998. With the devaluation, Brazilian domestic products became cheaper for Brazilians than Argentine
imports, “resulting in a 28 percent drop in Argentine exports to Brazil in 1999.” While exports to Brazil decreased, the international prices of agricultural commodities also dropped, further straining the economy.

With a poor financial system and decreased export opportunities, the Argentine government had trouble covering its budget deficit and debt payments. At first the IMF delivered several loan packages, worth billions of dollars, to the country, but, in December of 2001, because the Argentine government couldn’t balance the budget, the IMF decided against granting another loan. Without the IMF bailout, in order to meet its financial obligations, the Argentine government was forced to abandon the Convertibility Plan and devalue its currency. However, even then the government was unable to make payments to its creditors, and was forced to default on its debt. At the same time, in order to prevent a run on the banks, which had purchased large amounts of now worthless government bonds, the government froze bank accounts, a move called el corralito. The people went to the streets in a rage, and the ensuing political mayhem saw a quick succession of presidents.

The situation began to settle with the election of Nestor Kirchner in May of 2003. In February 2005, after a series of negotiations, a majority of creditors accepted Kirchner’s offer of 35 cents for each dollar of debt. The creditors’ rationale for accepting the deal was that 35 cents to the dollar was better than possibly no money at all. Such was the state of the nation that was once the world’s tenth largest economy at the beginning of the 21st century.
Analysis

Argentina emerged from its belle époque of the late 19th and early 20th century with an export-based economy and the belief that it was the next United States. The global economic situation of the Great Depression gave doubt to these aspirations and opened the door for Perónism. This movement sought to restore Argentina’s greatness by withdrawing from the cyclical world economy. Perón’s plans for ISI found favor with the labor unions, a group that he created into a Perónist powerbase. By turning the country’s back on the source of previous commercial success, Perón increased his own political power by increasing the role of the labor unions in Argentine society.

His plans for ISI were short-sighted. Argentina did not have a comparative advantage in industrial goods, except when it came to exporting to the limited regional markets of South America, a market with increasing competition from Brazil. Argentina’s comparative advantage lay in the exportation of agricultural goods. This sector, employing a fraction of the population, provided over fifty percent of its exports from 1961-1985. Although agricultural goods were subject to steep changes in prices, the pampas was fertile enough to allow Argentine farmers to switch among potentially profitable crops while the size of the nation allowed significant extensification.

The sale of beef and wheat brought in large amounts of foreign currency. This caused the real exchange rate to appreciate. At the same time, the expansion of the industrial sector, due to ISI-protection, led to greater levels of employment and higher levels of income, especially in the nontradable sector. Consumer spending rose from industrial workers in this sector and from agricultural laborers. As a result, inflation increased.
Due to government protection of traditionally uncompetitive industries, like car manufacturing, workers in these industries had no economic motivation for changing jobs, and the power of the unions in the Perón presidency and subsequent administrations/regimes meant the government had every incentive to protect industrial workers’ jobs or risk loss of power.

As the world economy recovered from World War II, the prices for many agricultural products decreased. Deprived of its largest source of revenue, and having already spent all the taxes collected from agricultural exports during the boom time, and with its industry internationally uncompetitive, successive Argentine governments were forced to borrow ever increasing amounts of money to cover their debts. The rising national debt exposed the country to the very outside economic influences which ISI had been designed to mitigate. Ultimately, it was this rising debt, sparked by the conditions of the Dutch Disease and enlarged by government mismanagement, that caused the collapse in 2001.

The repeated macroeconomic mismanagement by the government has led to a loss of trust not only between foreign investors and the Argentine state but also between the Argentine government and its people. Without trust, future governmental policies designed to improve the economy will be met with cynicism. The immediate goal of Kirchner and future Argentine presidents will be to restore this trust by minimizing corruption, keeping inflation down, and creating growth with sound, non-populist economic policies.
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