

# Argentina: Default and Beyond

## What Lessons for Europe?

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The current debt crises in several European countries warrant a close look at Argentina's substantial experience with debt crises, default and debt restructuring. Argentina's December 2001 default is particularly relevant to the current situation in the European periphery. We shall present an overview here in the hope that it may serve as a possible alternative to the Troika's austerity and the deepening of neoliberalism.

Argentina's recent experience can best be explained as a three-stage process. The first stage deals with Argentina's neoliberal economic policies and the resulting unsustainable debt build-up. The second stage deals with the default and subsequent remarkable recovery. The final stage deals with the current economic problems, which began in 2007, and have been the subject of several recent scathing mainstream media articles. In what follows, each stage will be described concluding with some possible lessons.

### **Stage 1—Neoliberal policies and unsustainable debt accumulation**

The story of Argentina's 2001 debt crisis starts in 1976, with the bloodiest military coup in the country's history. With the coup, and not coincidentally, came the first wave of neoliberal economic reforms, primarily financial deregulation and opening up to foreign capital flows.

Since 1976 Argentina has had two major cycles of unsustainable debt accumulation, default and restructuring. The first cycle was during the military dictatorship itself: between 1976 and 1983, Argentina's public debt quintupled. This debt, mostly with Northern banks, was subject of a court case that documented hundreds of irregularities. The trial provided solid evidence for considering this debt both illegitimate and odious,<sup>2</sup> but unfortunately Argentine governments to date have never exploited this opportunity. Indeed, the current debt negotiations between the Argentine government and the Paris Club are over debt contracted during the military dictatorship.<sup>3</sup>

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<sup>2</sup> The documentation provided as evidence for the trial was the closest Argentina came to a debt audit, except that it was not an official initiative, but that of a private citizen and lawyer, Alejandro Olmos Gaona.

The second major cycle of debt accumulation occurred between 1991 and 2001. Argentina's public debt increased from 60 billion dollars to 144 billion dollars over the decade. Debt service became unsustainable and in 2001 Argentina performed the largest sovereign default to date. We will focus briefly on this second debt cycle and the inevitable default.

What were the main causes for this spectacular debt accumulation and default? The main reason was the privatisation of social security in 1994, a policy strongly promoted by the International Monetary Fund (IMF) and the World Bank (WB) around the world in the 1990s, and still a favourite of financial markets. Data clearly show that debt service and debt levels began to grow in 1994 following social security privatisation.

How did social security privatisation result in growing debt? The mechanism was quite simple: worker pension contributions, which used to go to the State system, were diverted to private banks. However, the State had to continue to make payments to all workers already retired on the State pension system. This gap between revenues and expenditures amounted to 1% of GDP each year since privatization and, given Argentina's currency board arrangement and inability to increase taxes, was covered with new debt.

Other factors contributing to debt build up were foreign interest rate increases, which resulted in higher debt service payments. Additionally, when in 1998 it became clear that the currency board's days were numbered, capital flight increased substantially. Given Argentina's currency board and monetary rules, foreign reserves had to be maintained in order to maintain peso liquidity, so the drain on reserves produced by capital flight was covered with foreign debt.

It is relevant to examine the IMF's role in Argentina, because there are many striking parallels with what the IMF and the Troika are doing in Europe today. When in 1998 (three years before default) it became clear that Argentina's policy framework was not sustainable and private external funding began to dry up, Argentina turned to the IMF who provided loans with its usual conditions of fiscal austerity.

However, the problem was, as is usually the case, that the IMF's diagnosis of the Argentine situation was mistaken. The IMF claimed that Argentina's problem was profligate fiscal spending not supported by fiscal revenue. However, official data show that this was not the case. Debt payments aside, Argentina was running a small primary fiscal surplus throughout the

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<sup>3</sup> Indeed, current president Cristina Fernández de Kirchner has publicly stated that there is no illegitimate debt (*La Nación*, January 14<sup>th</sup>, 2010).

1990s (with the exception of 1996). The only component of public expenditure that was growing out of control was debt service. This means that Argentina had a debt problem, not a fiscal problem.

The IMF's mistaken diagnosis led to the wrong policy prescriptions. As any introductory macroeconomics student should know, fiscal spending cuts in a recession will only deepen the recession (with skyrocketing unemployment, poverty and hunger rates). This indeed happened in Argentina, deepening the country's insolvency and making default inevitable. If this sounds familiar to Europeans it should: it means that IMF (and the Troika) is still out there destroying economies and livelihoods based on faulty economic theory that leads to mistaken diagnoses and the wrong policy prescriptions with disastrous consequences.

Before looking at the impact of default on Argentina's economy, we should note that both debt cycles were the result of an intensely neoliberal economic policy framework, to which the IMF and WB contributed significantly. This points to a direct link between so-called "market friendly" policies, financial speculation and profiteering, debt accumulation and crisis. We should also note that none of this is socially neutral: unemployment, poverty, inequality and structural social exclusion have been long-lasting results of these cycles.

## **Stage 2—Default: dead end or new beginning?**

By December 2001, in the midst of considerable political, social and economic turmoil, Argentina's debt burden was no longer sustainable leaving two options available. The first was to try to continue the policy of borrowing to cover debt service, implementing further IMF fiscal spending cuts. This would have deepened the economic recession and the social crisis leading to a never-ending downward spiral.

The second option was to default, make corrections to the economic policy framework and try to start over. The political and economic crisis in Argentina in December of 2001 was such that the only real alternative was to default, which Argentina did.

In February 2002, Argentina also abandoned the fixed exchange rate (or convertibility) regime which had been in existence since 1991. The convertibility regime pegged the peso to the dollar on a one-to-one exchange rate which resulted in a de facto voluntary renouncement of the possibility of conducting independent monetary and exchange rate policies (not unlike the euro framework today, except in the Argentine case it was a unilateral, single-country decision). Therefore, by eliminating the peg to the dollar Argentina

recovered its monetary sovereignty and with it the ability to conduct independent fiscal, monetary and exchange rate policies. Additionally, Argentine officials devalued the currency, improving international competitiveness of domestically produced goods while making imported goods more expensive and therefore providing incentives for domestic production.

So, did default result in the fire and brimstone destruction that pundits predict for the European periphery countries should they try to follow Argentina's example? Well, no, quite the opposite! Default immediately reduced external payment obligations freeing up very much needed fiscal resources for more immediate needs. It also eliminated in one fell swoop Argentina's dependence on foreign capital markets: since the country was borrowing to service its debt, defaulting eliminated the need to borrow. So it did not matter if foreign capital markets were available to Argentina since they were no longer needed. Additionally, this meant that Argentina no longer had to submit to IMF tutelage, since it was no longer requesting IMF loans.<sup>4</sup>

Furthermore, recovering monetary sovereignty enabled the country to conduct independent fiscal, monetary and exchange rate policies changing priorities away from pleasing financial markets to boosting demand, generating employment, and reducing poverty. Indeed, post default and devaluation, Argentina experienced seven years of unprecedented economic growth and recovery. The main factors explaining this were, first, a fiscal subsidy to the unemployed (which peaked at more than two million beneficiaries), essentially kick-starting internal demand and economic activity. Second, the currency devaluation made Argentine exports more competitive internationally, boosting export production. Third, devaluation also made imports more expensive, providing incentives for some degree of import substitution. Finally, international commodity prices were very high, which resulted in large trade surpluses and foreign reserve accumulation.

### **Stage 3—The enduring legacy of neoliberalism**

Starting in 2007, Argentina began to experience a series of economic problems and imbalances, some of which look a lot like Argentina's problems from decades past: moderate inflation (about 25% yearly), lower growth rates or mild recessions, a growing fiscal deficit due primarily to energy subsidies, capital flight and international reserves depletion, and increased social unrest due to purchasing power erosion. These problems have received much attention in the mainstream and neoliberal international media, who blame current economic difficulties on the default and populist economic policies.

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<sup>4</sup> Argentina tried to renegotiate its debt with the IMF for a few years following default, but in order to do that the IMF required further austerity. Tired of these demands, in 2005 President Néstor Kirchner paid off the IMF in full, three years in advance of loan due date.

Before discussing what we believe to be the cause of current problems, it is important to clarify that they have absolutely nothing to do with the default and devaluation. Only ideological blinders, like those worn by many mainstream media journalists, could maintain a link between default and current problems. Interestingly, not even the most neoliberal pundits in Argentina link current problems to default. And there is good reason for this: there is no empirical evidence to sustain the claim as they are completely unrelated.

The government's response to the problems mentioned above has been erratic and disappointing. When inflation began to increase in 2007, rather than diagnosing the sources of inflation and attempting to deal with them, the government decided to alter official statistics. Eventually, all official statistics, including national growth accounting, were falsified trying to hide inflation and its consequences.

The government also attempted to implement price controls which had only short term impacts and didn't really contribute to a sustained lowering of overall inflation. In the presence of enduring inflation, with the resulting real exchange rate appreciation and a growing fiscal deficit, the government has opted for a typical short-term IMF-style neoliberal adjustment package: currency devaluation, monetary contraction and interest rate hikes, wage repression and fiscal spending cuts. Additionally, the government is doing everything necessary to go back to the international capital markets to issue new public debt.

So then, what went wrong? Or, in other words, why this return to the pre-default past? If defaulting and recovering monetary sovereignty were so successful for the seven years following the crisis, what are the reasons for the current situation?

The answer is simple and perhaps obvious, but I believe it to be at the centre of current problems. Between 1976 and 2001 Argentina underwent a profound structural transformation based on neoliberal policies and ideology. Undoing such a profound transformation and restructuring will not happen automatically, it requires deliberate and planned action. Argentina has yet to undertake the process of structural transformation to undo the neoliberal heritage, and until it does it risks returning cyclically to the neoliberal maladies. In other words, default and recovering currency sovereignty were necessary but not sufficient to break with the neoliberal past.

What were the transformations that resulted from 25 years of neoliberalism in Argentina? They were profound and extensive, affecting all aspects of the country's life. Some of the economic impacts were: deindustrialisation and a reprimarisation of the economy, returning Argentina to a strong dependence on primary exports with little value added; strong economic concentration and foreign ownership increasing monopoly power, reducing the ability to impact decisions on productive investment and deepening balance of payments problems as foreign corporations sent profits abroad; financialisation of the banking system and capital markets resulting in short-term consumer lending and speculative activities replacing long-term credit for production; the privatisation of key public utilities and the energy sector; a profound transformation of the State and the elimination of planning and regulatory agencies; a highly regressive tax structure by which the poor and working class contribute disproportionately to State revenues while interest income and capital gains are not taxed; decentralization of health and education increasing structural inequality in access to basic services as their provision became dependent on local jurisdiction budgets; and labour market deregulation and weakening of labour's organisations resulting in enduring structural unemployment, poverty, hunger and social exclusion. Many of these processes have continued during the past ten years, as witnessed by record bank profits and increased foreign ownership and concentration since 2001.

In addition to these profound economic, social and political transformations, there is a considerable ideological legacy of individualism and social atomisation, consumerism, a loss of a collective approach to social and economic transformation, and a "blame the victim" approach to social and economic problems. An additional ideological legacy is the focus on economic problems as belonging to a single country and not as pertaining to the functioning of the world capitalist economy, increasingly neoliberal, and the unequal impact that this system has on centre and periphery countries.

Disarticulating the networks of concentrated power and individualistic ideologies characteristic of neoliberalism and rebuilding the State will not happen automatically or with fiery rhetoric and short-term policy making. It requires a clear diagnosis, a medium- to long-term vision of where the economy and society should go, a specific plan of how to get there and a State able to implement that plan and make corrections as needed. Unfortunately, this is a debate that is still pending in Argentina, and the current problems are a reflection of that.

What would have to be done in order to overcome neoliberalism? Clearly that is a hugely complex undertaking that should be broached collectively and with the widest consensus possible. Here we will only enumerate some of the

economic policies that we consider necessary in order to undo this nefarious legacy and embark on a long-term structural transformation towards an economy centred on sustainability and the well-being of its workers and not on corporate financial profiteering.

Perhaps the most critical aspect of undoing the neoliberal legacy is rebuilding the State. Neoliberal restructuring has left a State whose primary role has been to guarantee private sector profits. In order to leave neoliberalism behind we need a State that is able to plan and to intervene effectively in the economy and that is able to open up participation to different sectors of society.

The banking system needs to be completely overhauled. Since the financialised banks currently operating in Argentina have not been financing long-term productive investment and most likely will not want to do so, the financial system should be restructured around a public bank core. If nationalisation is considered politically too costly, then the State should create national banks that can provide savings vehicles for households and firms and finance productive investment for development.

Industrial policy is yet another building block for long-term structural change. Nostalgia for the import-substitution years should be avoided—the world today is very different from what it was in the mid-twentieth century. Current “global value-chain” fantasies, according to which periphery countries will develop by participating in global production chains, should also be avoided. Studies clearly show that countries in the periphery still participate and compete in global production based on cheap labour, whereas most of the high-valued added conception and technology development work occurs in centre countries. Clearly this pattern does not lead to development in the periphery. A new paradigm is needed and a good starting point is the re-examination of Latin America’s critical development theories of the second half of last century, structuralism and dependency theories, although acritical linear attempts at adaptation to today’s world should be avoided. Issues, such as environmental sustainability, should clearly be an integral part of any proposal.

Additionally, the opportunity should be taken to promote cooperative and other forms of collective ownership of the means of production through legislation, credit, etc. Argentina has a small yet significant worker-run and cooperative sector that emerged from the crisis. Unfortunately, there have been no national policies or legislation to protect and promote this type of enterprises providing facilities for their development. This is clearly a missed opportunity which should be amended.

Finally, in this short list of basic measures, a profound tax reform should be undertaken. In Argentina today, with a 21% value added tax which amounts to more than a third of fiscal revenue, the poor and working people pay a disproportionate share of taxes. Meanwhile, earned interest income and capital gains are not taxed at all. It is time generate a progressive tax structure, where the wealthy and corporations contribute proportionately to their income, assets and profits. Parallel to tax reform, a widespread education campaign is needed to replace the individualistic and anti-solidaritous behaviours promoted by neoliberalism with the belief that social solidarity is the basis of progress and that those who have more should contribute more to the common good.

### **Argentina's lessons**

There are several important lessons that can be drawn from the Argentine experience, bearing in mind that each country has specificities of its own and that no linear transposition can be made from one country to the next.

The first lesson is that a small, peripheral nation can make sovereign decisions about whether to continue to service its debt. If a country chooses to break the stranglehold of international financial markets and the IMF, it can do so unilaterally as Argentina's experience shows.

Second, default is an option to be considered as it frees up fiscal resources and makes available policy space to change course. This was indeed the case for Argentina, as post-default economic performance indicates.

Third, recovering monetary sovereignty is key in order to be able to carry out independent, people-centred, fiscal and monetary policies.

Finally, it is not enough to default and recover monetary sovereignty to overcome neoliberalism's nefarious legacy. It is also necessary to have specific plans—based on a clear assessment of neoliberalism's profound impact—in order to produce the social and economic structural transformation towards greater equity and sustainability. If overcoming neoliberalism is not explicitly and deliberately pursued, a return to the past is not unlikely as Argentina's current situation sadly shows.