Introduction:
The Great Unraveling: Argentina 1973-1991

> *In spite of its enormous advance which the Republic has made within the last ten years, the most cautious critic would not hesitate to aver that Argentina has but just entered upon the threshold of her greatness.*
>
> Percy F. Martin, *Through Five Republics of South America,* 1905[1]

> *The truth is that Argentina is bankrupt – economically, politically and socially. Its institutions are dysfunctional, its government disreputable, its social cohesion unstuck.*
>
> Ricardo Caballero and Rudiger Dornbusch, *Financial Times*, March 8 2002[2]

By the end of the nineteenth century, Argentina's economic future looked indeed bright. On the eve of World War I, the Argentine capital Buenos Aires proudly displayed its affluence and modernity in its big administrative buildings, extensive parks and an underground railway. European fashion and consumer goods were in high demand and Buenos Aires even attracted a sizeable intellectual and scientific community.[3] By all measures of the time, Argentina could be regarded a modern country. Yet, at the beginning of the twenty-first century, Argentina is seen as the "sick man of Latin America".[4] The economic and political crisis, which Argentina experienced in 2001 and 2002, was arguably the worst since the country's independence. Over the course of two years, output fell by more than 15 percent, the Argentine peso lost three-quarters of its value, and registered unemployment exceeded 25 percent while more than half of the population of the erstwhile rich country lived below the poverty line.[5]

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[1] Percy F. Martin, *Through five republics (of South America) : a critical description of Argentina, Brazil, Chile, Uruguay and Venezuela in 1905* (New York, 1906). p. 2

[2] Ricardo Caballero and Rudiger Dornbusch, "Argentina cannot be trusted," Financial Times, March 8 2002.

[3] Ezequiel Gallo, "Argentina: Society and Politics, 1880-1916," in *The Cambridge History of Latin America*, ed. Leslie Bethell (1984). p. 373.

[4] "The Slow Road to Reform," *The Economist*, Dec. 2nd, 2000.

[5] The Argentine Instituto Nacional de Estadística y Censos (INDEC) reported that in May 2002, 53 percent of the population lived below the poverty line. In October of the same year the figure reached an even higher level of 57.5 percent. Source: http://www.indec.gov.ar/

A lot of attention has focused on economic policy making in the 1990s and the immediate reasons for collapse during the year 2001.[6] Critics of the policy of economic liberalization pursued during the Presidency of Carlos S. Menem argued that Argentina became a victim of “neoliberalism”, which had been actively promoted by the U.S. government and the International Monetary Fund (IMF) under the “Washington Consensus”.[7] Proponents of this view hold that Argentina needed a complete break with the economic model of the 1990s in order to return to economic growth and eliminate rampant social injustice.[8] Some Argentine commentators even blame the Washington-based institution to be co-conspirators of “terrorismo económico,” a deliberate destruction of the economy by devious elements of world financial capital.[9] Others have stressed that the main shortcoming of economic policy-making during the 1990s was that economic reform was not pursued with enough determination.[10] Proponents of this view hold that Carlos Menem and Fernando de la Rúa, his successor in the *Casa Rosada*, the government house in Buenos Aires, had been unable or unwilling to control public spending, which contributed to a buoying foreign debt. Together with the fixed exchange rate arrangement of the *Convertibility* Program, Argentina thus became vulnerable to the sudden reversal of financial flows.[11] If the IMF was at fault, proponents of this view argue, it was not because they imposed “orthodoxy” but rather because they were too lenient with Argentine governments.[12]

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[6] Paul Blustein, *And the Money Kept Rolling In (And Out): Wall Street, the IMF, and the Bankrupting of Argentina* (New York, 2005).

[7] See, e.g., Enrique Arceo, "Hegemonía norteamericana, internacionalización financiera y productiva y nuevo pacto colonial," in *La guerra infinita, Hegemonía y Terror Mundial*, ed. Ana Esther and Emir Sader (Buenos Aires, 2002), Philip Oxhorn and Graciela Ducatenzeiler, *What kind of democracy? What kind of market? : Latin America in the age of neoliberalism* (University Park, Pa., 1998).

[8] Jorge Schvarzer, *Convertibilidad y deuda externa*, 2. ed. (Buenos Aires, 2003), Universidad de Buenos Aires. Facultad de Ciencias Económicas., *Hacia el Plan Fénix : una alternativa económica*, 1a. ed. (Buenos Aires, 2001).

[9] Jaime Fuchs and José Carlos Vélez, *Argentina de rodillas : terrorismo económico de Martínez de Hoz a Cavallo*, 1. ed. (Buenos Aires, 2001). This expression was originally used by Peronists. During early 1976, Isabel Perón claimed made similar accusations to explain the economic breakdown, see "Alza de salarios y ataque al agio," *La Nacion*, March 11, 1976.

[10] Guillermo Perry and Luis Serven, "Argentina's Macroeconomic Collapse: Causes and Lessons," *draft chapter* (2004), Mario Teijeiro, "Una vez más, la política fiscal..." *Centro de Estudios Públicos* (June 15, 2001).

[11] Pablo E. Guidotti, Federico Sturzenegger, and Agustín Villar, "On the Consequences of Sudden Stops," *Mimeo, Universidad Torcuato di Tella* (2003).

[12] Michael Mussa, *Argentina and the Fund : from triumph to tragedy* (Washington, DC, 2002).

The crisis literature, which followed the crash of 2001 was preceded by a long tradition of scholarship, which attempted to explain the apparent mystery of how an erstwhile rich country could have impoverished. The reasons and exact timing of Argentina's decline from one of the ten richest countries of the planet at the beginning of the twentieth century to a struggling middle income country at the turn of the twenty-first was a matter of intense debate. Some observers stressed Argentina's dependency on capital imports from Great Britain during the *belle époque* and argued that World War I was the turning point for Argentine economic fortune. During World War I, foreign investment in Argentina came to a complete standstill from which it never fully recovered.[13] The post-war recovery was short-lived and marked by scarcity of foreign investment. This can partly be attributed to the shift of the world financial center from London to New York. Great Britain had become heavily indebted to the United States during the war and would no longer export capital at a scale comparable to the *belle époque*. The United States, which came out of the war a political and financial superpower, showed no great interest in Argentina, which it perceived as a potential rival on world markets.[14]

A second line of argument held that the decisive break in Argentine economic development occurred during the Great Depression when increasingly protectionist measures in industrialized countries hurt Argentine exports and pushed it towards an inward-looking development strategy.[15] Argentina reacted with a set of economic policies, which were perceived to be highly unorthodox at the time. Earlier than most countries, Argentina abandoned the gold standard in December 1929 and adopted protectionist trade measures and active state involvement in the economy.[16] These measures helped shield Argentina from the worst consequences of the Depression. However, it also marked the beginning of a new model of economic development based

[13] David Rock, "Argentina from the First World War to the Revolution of 1930," in *The Cambridge History of Latin America*, ed. Leslie Bethell (Cambridge, Eng., 1984). p. 419

[14] Alan M. Taylor, "External Dependence, Demographic Burdens, and Argentine Economic Decline After the Belle Epoque," *Journal of Economic History* 52 (1992).

[15] Carlos F. Díaz Alejandro, "Latin America in the 1930s," in *Latin America in the 1930s : the role of the periphery in world crisis*, ed. Rosemary Thorp (New York, 1984). p. 21.

[16] Gerardo della Paolera and Alan M. Taylor, *Straining at the Anchor: The Argentine Currency Board and the Search for Macroeconomic Stability, 1880-1935*, ed. National Bureau of Economic Research., Series on Long-Term Factors in Economic Development (Chicago, 2001), Carlos F. Díaz Alejandro, *Essays on the economic history of the Argentine Republic* (New Haven, 1970).

on import substituting industrialization, which would undermine Argentina's economic growth and result in permanent economic instability.[17]

A third strand of historians blamed Colonel Juan Domingo Perón and his legacy for irrevocably changing Argentina from an "outpost of Europe in South America" into a sclerotic and deeply divided society.[18] Colonel Juan Domingo Perón, who came to power as head of the Ministry of Labor following a military coup in 1943, succeeded in uniting the labor movement behind his agenda of "social justice," which entailed higher wages and social reform coated in rhetoric of nationalism. After Perón's election as President in 1946, Argentina embarked on a strategy of state-led industrialization, diverting resources into industrial capital formation by protection and subsidies that changed relative prices and earnings in favor of industry while discriminating against agricultural producers. The broad outlines of this "developmentalist" strategy remained in force even after Perón's ouster in a military coup in 1955. While this strategy led to relative rapid growth during the 1950s and 1960s, this growth was accompanied by frequent balance of payments crises, which led to even more protectionist measures thus creating irrational "geological" tariff structures.[19] Excessive and inefficient protection created an incentive for rent-seeking corruption and misallocation of resources.[20] The economic stop-go-cycles also undermined the governability of the country and led to a series of military interventions to overcome economic crises.[21]

This study challenges both the recent fixation on the 1990s and the idea that Argentina has been in permanent decline for the better part of the 20th century. Instead it argues that Argentine postwar growth was relatively successful. Argentine per capita income grew at an average rate of more than two percent per year between 1950 and the

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[17] Gerardo della Paolera and Alan M. Taylor, "Economic Recovery from the Argentine Great Depression: Institutions, Expectations and the Change of Macroeconomic Regime," *NBER Working Paper* 6767 (1998), della Paolera and Taylor, *Straining at the Anchor: The Argentine Currency Board and the Search for Macroeconomic Stability, 1880-1935*.
[18] Mark Falcoff and Ronald H. Dolkart, *Prologue to Perón : Argentina in depression and war, 1930-1943* (Berkeley, 1975). p. x
[19] David B. Humphrey, "Changes in Protection and Inflation in Argentina, 1953-1966," *Oxford Economic Papers* 21 (1969), Edmund J. Sheehey, *Stabilization policy and protective discrimination in Argentina, 1967-1971* (1981).
[20] Deepak Lal, *The poverty of "development economics"* (Cambridge, Mass., 1985). p. 5
[21] Carlos F. Díaz Alejandro, "Stop-Go Cycles and Inflation during the Postwar Period," in *Essays on the Economic History of the Argentine Republic*, ed. Carlos F. Díaz Alejandro (New Haven, 1970).

early 1970s, almost as fast as during the last decade before World War I and substantially faster than during the 1920 and 1930s. However, they fell short of expectations because of even higher rates of growth in industrialized countries, especially the United States, Canada, Western Europe, and Australia. Argentina only began to impoverish itself in the mid-1970s (see Figure 1).

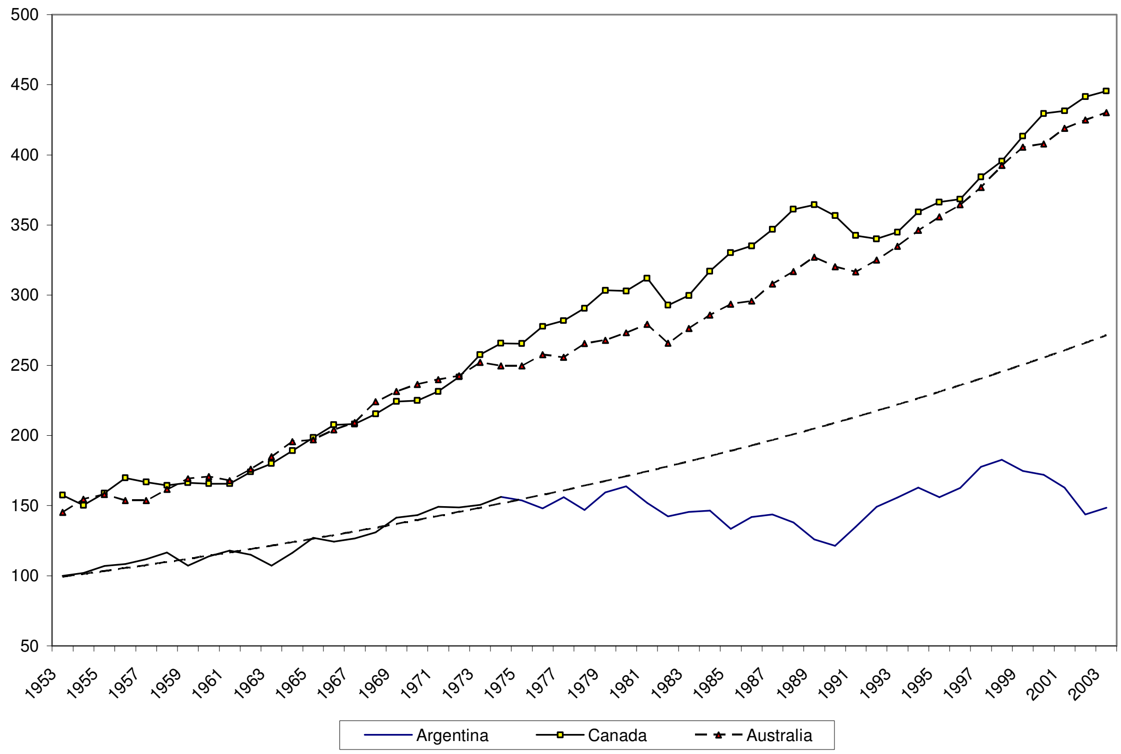

Figure 1: Argentine postwar growth and exponential trend based on growth between 1953 and 1974, compared to the growth of Australia and Canada, per capita income in constant local currency, Index: Argentina in 1953=100[22]

Between 1975 and 1990, real per capita income fell by more than twenty percent wiping out almost three decades of economic development. Despite the rapid economic growth during the 1990s, Argentina remained far below its post-war trend. If Argentina had managed to continue growing at the same rate as during the 1950s and 1960s, real per capita income would be almost twice as high today as it actually is and would have followed a trajectory similar to Canada and Australia.

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[22] Gerardo della Paolera and Alan M. Taylor, *A new economic history of Argentina* (Cambridge ; New York, 2003). Database on CD, World Bank, World Development Indicators Database Online, and Penn World Tables, http://pwt.econ.upenn.edu/

It is no coincidence that the 1970s were a turning point for Argentine economic development. The 1970s brought important structural changes, which led to a profound crisis of the very model of the political system and economic development, which had dominated the postwar era. This was not only the case in Argentina but throughout the Western World. Two developments coincided at this historical juncture, namely the gradual liberalization of financial markets and the international lending boom following the first oil shock of 1973 on the one hand and the transformation of advanced economies from being based on manufacturing and heavy industry to increasingly relying on service sectors on the other.

During the postwar decades, developing countries, lacking sufficient internal savings, had been unable to borrow the necessary funds on international capital markets. Consequently, they periodically suffered under balance of payment crises caused by "exchange bottlenecks".[23] International development agencies such as the World Bank hoped that with the help of a rapidly expanding international financial market eager to lend, developing countries would be able to sharply increase investment in order to achieve what W.W. Rostow had called "takeoff into self-sustained growth.[24] The unexpected easier availability of capital now offered opportunities for developing countries to sharply increase their investment and growth prospects. However, it also posed a significant threat. During the postwar period, governments had been restrained in their spending by the lack of foreign capital. Fiscal deficits had to be financed domestically, oftentimes with the help of the printing press, which led to a chronic problem of inflation in Latin America during the post-war period.[25]

With the opening of world financial markets, governments were suddenly able to finance large fiscal deficits, expansive monetary policies, and misaligned exchange rates much longer. However, the long-term costs of these policies were also much higher. The

[23] Díaz Alejandro, "Stop-Go Cycles and Inflation during the Postwar Period."
[24] McNamara, Robert S., "The Second Development Decade: Working Together", Speech delivered before the U.N. Economic and Social Council, United Nations, New York, November 13, 1970. William Russell Easterly, *The elusive quest for growth : economists' adventures and misadventures in the tropics* (Cambridge, Mass. ; London, 2001). p. 38 W. W. Rostow, *The stages of economic growth, a non-Communist manifesto* (Cambridge Eng., 1960).
[25] Juan E. Alemann, *La inflación endémica en la Argentina* (Buenos Aires, 1963), Tom E. Davis, "Inflation and Growth in Latin America: Theory, Performance and Policy," *Economic Development and Cultural Change* 14 (Jul., 1966), Díaz Alejandro, "Stop-Go Cycles and Inflation during the Postwar Period."

foreign debt, which countries accumulated during the years of easy money, would haunt Latin American countries for the remainder of the century and beyond and fundamentally changed the dynamic of economic policy-making. With a large foreign debt, governments lost some of their time-tested measures to stimulate the economy. The post-war period had been characterized by stop-go cycles, whereby populist and expansionary policies were followed by sharp devaluations and recessions, which helped to restore the external equilibrium.[26] Unlike domestic financing, international debt could not be "inflated away". Also devaluations would no longer help stabilize the economy. Since the debt was denominated in dollars, devaluation sharply increased the real value of the debt in terms of domestic currency and could rapidly convert a balance of payment crisis into a "twin crisis" pushing banks, private borrowers, and even the government to the brink of bankruptcy.[27]

How did different Latin American countries deal with the challenges posed by the changing world economy in the 1970s? Figure 2 reveals several important insights about differences and similarities in the experiences of major Latin American economies during this period. Argentina was by far the most prosperous country in this comparison. The per capita income in Argentina was twice as high as in Mexico and more than three times as high as in Chile and Brazil in the early 1970s. Argentina was also by far the least successful economy during the 1970s and 1980s. By 1990, the difference in income between Argentina and the other Latin American countries was much smaller than at the beginning of the 1970s. While Brazil and Chile's per capita income now reached more than half of Argentina's, Mexico's was a mere ten percent below it. Why was Argentina's economic performance so much worse than the other countries'? Two aspects stand out: First, Argentina failed to participate in the emerging market boom during the second half of the 1970s. Between 1975 and 1980, per capita income in Argentina rose by a mere seven percent, while Brazil, Chile and Mexico registered an economic expansion of more than a quarter. Second, Argentina had by far the worst

[26] Díaz Alejandro, "Stop-Go Cycles and Inflation during the Postwar Period."

[27] "Twin crises" are simultaneous balance of payment and banking crises. They occur when the private and public sector has a large amount of debt denominated in foreign currency. In the case of a sharp devaluation of the exchange rate this can lead to widespread bankruptcies and collapse of the banking sector. See, e.g., Graciela L. Kaminsky and Carmen Reinhart, "The Twin Crises: The Causes of Banking and Balance-of-Payments Problems," *American Economic Review* 89 (Jun., 1999).

performance during the “lost decade” of the 1980s. While per capita income fell by three to four percent over the decade in Brazil and Mexico and continued to grow strongly in Chile, Argentina suffered a dramatic contraction of almost 25 percent.

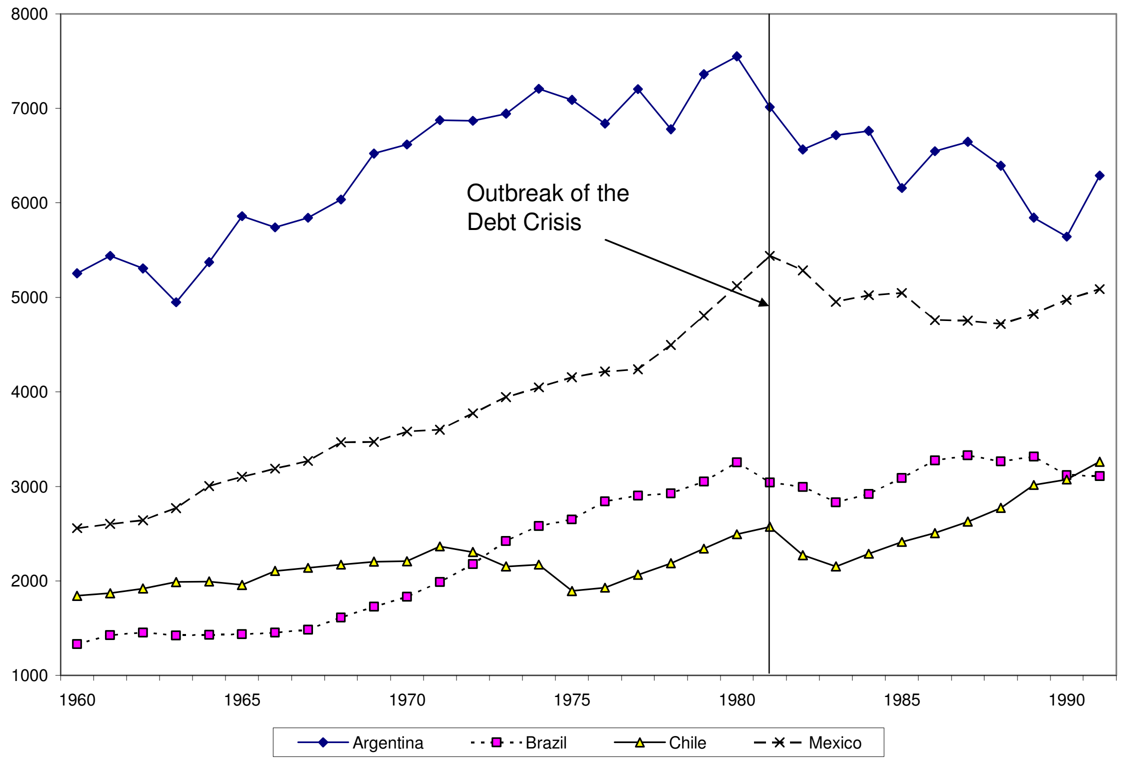

Figure 2: Argentina, Brazil, Chile, and Mexico during the critical decades of the 1970s and 1980s, per capita GDP in constant 2000 US dollars. Source: World Bank, World Development Indicator Database

The Argentine public has often blamed the United States and the IMF for the economic problems the country encountered. This perception has a long tradition going back to the 1940s when Juan Domingo Perón positioned himself against what he perceived as economic domination by the United States. Perón and many of his followers believed the U.S. to be a natural ally of the Argentine aristocracy and financial interests and therefore an enemy in their struggle for national liberation. Argentine observers have also often portrayed the IMF as a mere agent of the United States, which surreptitiously tried to force the country into submission.[28] Peronist governments were the most reluctant to

[28] For more recent literature see, e.g., Alicia Frohmann, *Democracia, deuda externa y disciplinamiento económico : las relaciones entre Argentina y los Estados Unidos, 1983-1985* (Santiago de Chile, 1986), Norberto Galasso, *De la Banca Baring al FMI: Historia de la Deuda Externa Argentina* (Buenos Aires,

deal with the international organization. Consequently Argentina did not join the IMF until after the military coup against Juan D. Perón in 1955 and more than ten years after Brazil, Chile and Mexico had joined the international organization. When the Peronist government under Maria Estela Martínez de Perón started to experience a balance of payment crisis in 1975 and needed external help, the resistance to asking the IMF for help was such that the government publicly denied that these negotiations even took place.[29]

This study asserts that the influence of the U.S. government and international organizations was much more limited than most observers pretend. This can be explained by two factors: (1) Argentina was never a high priority in the U.S. foreign policy agenda (except for the brief months of the South Atlantic conflict in early 1982), and (2) the U.S. was unable to fully control international organizations such as the IMF, so that Argentina was able to play them against one another. Both lack of determination and conflicting goals of U.S. government and the IMF became evident in relation to constitutional as well as *de facto* governments. Unlike the case of Chile in 1973, the U.S. government and the CIA did not actively participate in preparations for the military coup, which ousted Maria Estela Martínez de Perón on March 24, 1976, even though they had previous notice of the plans and were broadly in favor of it. The incoming Carter Administration sharply opposed the Argentine dictatorship for their human rights abuses. The economic pressure they tried to apply, however, was of almost no consequence partially because the economic policies initially enjoyed the full support of the IMF, the World Bank, and the international financial community. After the return to democracy, Reagan embraced the newly elected President Raúl Alfonsín and James Baker, Secretary of the Treasury during Reagan's second term in office, enjoyed a very close working relationship with his Argentine counterpart Juan V. Sourrouille. However, this did not guarantee the desired outcome. In 1988, the Secretary of the Treasury James Baker applied considerable pressure on the World Bank and the IMF to continue supporting the faltering Austral Plan. The World Bank gave in to the pressure while the IMF resisted

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2003), Naúm Minsburg and Irma Antognazi, *Los guardianes del dinero : las políticas del FMI en la Argentina*, 1. ed., Tiempos de cambio; (Buenos Aires, 2003).

[29] Antonio Cafiero, Minister of Economics during the first negotiations between a Peronist government and the IMF, denies to this day that the contacts actually amounted to negotiations. Source: Interview with Antonio Cafiero, June 24, 2004

the pressure successfully. This episode caused a painful rift between the two sister-institutions and the refusal of the IMF to give in to U.S. demands for a more lenient treatment of Argentina was one of the triggers of the devastating hyperinflation.[30]

This suggests that the IMF enjoyed considerable autonomy vis-à-vis the United States. At the same time, the IMF became an important actor only during crisis moments when the Argentine government had no choice but to ask for its financial help. This was the case during a short period between the second half of 1975 and early 1977 and then again with the outbreak of the Debt Crisis in 1982. Even during moments of acute crisis, the IMF was far from a position to "impose" austerity measures on a country. Rather, Argentina successfully used open threats of default and pleas for special help to a democracy under attack as bargaining tools in negotiations with the IMF.[31] The IMF was more willing to grant special concession to Raúl Alfonsín in the mid-1980s than to Isabel Perón a decade earlier because of the perception that the stakes were higher during the Debt Crisis of the 1980s and the implicit hope by many at the IMF that the military coup in 1976 might facilitate economic stabilization in early 1976. More important than the concessions the IMF granted Argentina in the negotiations was the inability of the IMF to oblige the authorities to live up to the promises they had made. In this case the IMF could only declare the country in breach of the agreement and cut additional financing. This occurred both during the final months of the Presidency of Isabel Perón and the last year of the government of Raúl Alfonsín, where the breakdown of negotiations accelerated the collapse of the economy and downfall of the government in power.

The most important aspect of the Argentine crisis, however, are of domestic political origin. This study argues that Argentina failed to seize the new opportunities the transformation of the world economy offered countries to export and grow. Instead, the country became trapped in a permanent struggle over how to adapt to the new challenges during the critical decades of the 1970s and 1980s. While Mexico's trade openness – measured as exports and imports as share of GDP – increased sharply from 17 percent in the first half of the 1970s to 33 percent during the second half of the 1980s, Argentina

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[30] Devesh Kapur, John Prior Lewis, and Richard Charles Webb, *The World Bank : its first half century*, 2 vols. (Washington, D.C., 1997).
[31] Kendall W. Stiles, "Argentina's Bargaining with the IMF," *Journal of Interamerican Studies and World Affairs* 29 (1987).

essentially remained a closed economy throughout the 1970s and 1980s while the openness to trade fluctuated between 12 and 15 percent.[32]

This strategic indecision was exacerbated by an almost uninterrupted series of economic and political crises, which led the government to adopt short-term and often contradictory economic measures in a desperate effort to gain breathing space. Between 1973 and 1991, Argentina had no less than thirteen Presidents (including *de facto* and interim Presidents) and the transitions generally occurred in a haphazard manner with no regard to previously established timetables and without cooperation between the outgoing and incoming administration. The turnover in the Ministry of Economics was even more staggering. Within a span of eighteen years, Argentina had no less than twenty one Ministers of Economics. Maria Estela Martínez de Perón holds the sad record of having six Ministers of Economics in only twenty months in office.

The political and economic instability was also reflected in rates of inflation, which were extraordinary even for a country like Argentina, which had been accustomed to high inflation throughout the postwar period. During the 1950s and 1960s, the annual inflation rate had reached 27 percent. Starting with the *Rodrigazo* in 1975, inflation accelerated sharply, reaching more than 300 percent per year on average during the period 1975 to 1991. Between early 1975 and early 1991, when the *Convertibility Plan* finally ended the period of high inflation, prices in Argentina had increased by a staggering factor of 20 billion (see Figure 3). At the same time, high rates of inflation shorted the time horizons of economic actors, with additional destabilizing effects on the economy thus creating a vicious circle.

[32] World Bank, World Development Indicator Database

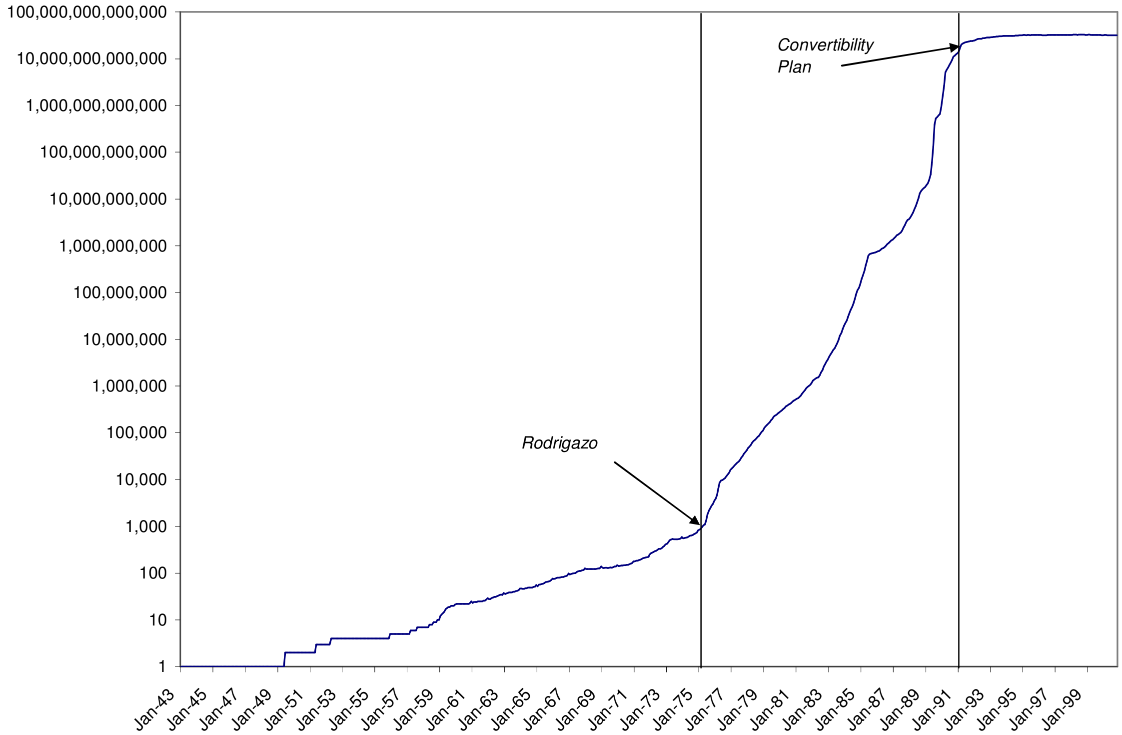

Figure 3: Postwar inflation, logarithmic scale, Consumer Price Index: Jan. 1943=1, Source: DataFIEL

This study rejects the idea that the economic disintegration was driven by "incompetence" of economic teams or by some hidden malicious intent. Instead, each new Minister of Economics reacted rationally to the crisis at hand. Each time, the incoming economic team implemented stabilization programs aimed at avoiding a further deterioration of the crisis and stabilizing the power of the government, which required the protection of the interests of powerful groups. However, measures which were political expedient and helped stabilize the economy in the short term oftentimes had important unintended consequences which would aggravate economic problems and call for ever more extreme emergency measures. To make matters worse, as political opponents and economic actors started to anticipate the destructive effects of the short-term measures, they contributed to an explosive political and economic situation. Political and economic interest groups resisted measures, which they perceived to be pernicious to their long-term interest. As a reaction they tried to force the government into concessions with work stoppages and slowdowns, known as "*trabajo con tristeza*" (work with sorrow) or attempted to circumvent regulations with the help of capital flight, contraband, and invoicing tricks. Even during the most severe political repression, the government never enjoyed unfettered power to implement its economic policy.

How could governments break out of the vicious circle of economic and political instability? This study argues that in their quest for stability, governments put special emphasis in creating confidence in their program. The stabilization programs tried to create credibility by pledging to rescind some of their independence by creating rules according to which they had to conduct their policy ranging from fixed exchange rates, pledges to eliminate inflationary financing to a zero deficit law.[33] Oftentimes these programs were backed by an agreement with trade unions and business groups not to raise prices and wages for a certain period of time. Since confidence is of such fleeting nature, symbolic actions became extremely important to sustain it. The selection of the Minister of Economics was therefore more often determined by his international standing or his contacts with powerful interest groups in the country rather than by the substantive reforms he stood for. The dependence on confidence for successful economic stabilization also created the preconditions for vicious circles as soon as it started to dissipate. Now trade unions had incentives to call for high wages and businesses to cheat on price controls. A fixed or quasi-fixed exchange rate also only generated stability as long as actors believed that the government would honor its commitment. As soon as confidence waned, rational actors would start speculating against the maintenance of the fix by transferring money out of the country in the form of “capital flight”. In the face of this challenge to their credibility, many governments would react with an “escalation of commitment” implementing increasingly desperate measures to defend their economic program without taking the long-term costs of their actions into consideration.[34]

However, with rising costs of maintaining the previous commitment, government became increasingly subject to pressure to abandon it. In a highly conflictual society

[33] This is consistent with the economic literature on “rules vs. discretion”. See, e.g., Finn E. Kydland and Edward C. Prescott, "Rules Rather than Discretion: The Inconsistency of Optimal Plans," *Journal of Political Economy* 85 (Jun., 1977), Patrick Minford, "Time-Inconsistency, Democracy, and Optimal Contingent Rules," *Oxford Economic Papers* 47 (Apr., 1995).

[34] See, e.g., Ming-Je Tang, "An economic perspective on escalating commitment," *Strategic Management Journal* 9 (1988), Glen Whyte, Alan M. Saks, and Sterling Hook, "When success breeds failure: The role of self-efficacy in escalating commitment to a losing course of action," *Journal of Organizational Behavior* 18 (September, 1997).

with limited respect for institutions this pressure frequently resulted in an unscheduled change in the economic team or even the government. The consequences of a long sequence of unstable governments imposing short-term measures and the breaking of supposedly inviolable commitments with little respect for constitutional rights and individual property were far-reaching. Companies learned to spend more money on bribes, political lobbying, and political consultants who specialized in second-guessing the government because they realized that anticipating economic measures was more profitable than productive investment and being on the wrong side of the next emergency measure could literally wipe out a company.[35] The lack of credibility of subsequent governments' commitment to uphold property rights created an important obstacle to long-term growth. As Mancur Olson argued, successful economic development critically depends on the protection of property rights. This requires a state, which is strong enough to protect its citizens from predators, and at the same time is restrained enough not to become a predator itself.[36] In Argentina, instead of protecting property rights, the state became what Carlos Escudé called "parasitic state", from which citizens needed to seek refuge.[37]

The repeated destruction of property rights prepared the ground for a system of "crony capitalism" in Argentina. As Stephen Haber explains, cronyism offers a second-best solution to the commitment problem. The government grants a privileged group of investors' special advantages in return for a share of the profits. In this way, members of the ruling political elite benefit from the economic well-being of this group of investors and have no incentives to violate the latter's property rights.[38] "Crony capitalism" has severe drawbacks, however, which can partly explain Argentina's political and economic turmoil during the past two decades. It leads to misallocation of resources into sectors,

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[35] Arriazu, Leone, and Lopez Murphy (1987) showed that the optimal debt strategy with the full use of the exchange guarantees virtually wiped out the debt, while the real debt burden rose nine-fold if the debtor was consistently on the wrong side of emergency measures. See Ricardo Héctor Arriazu, Alfredo M. Leone, and Ricardo Lopez Murphy, *Políticas macroeconómicas y endeudamiento privado: Aspectos empíricos* (Buenos Aires, 1987). p. 33

[36] Mancur Olson, *Power and prosperity : outgrowing communist and capitalist dictatorships* (New York, 2000). p. 196

[37] Carlos Escudé, *El Estado Parasitario: Argentina, ciclos de vaciamiento, clase política delictiva y colapso de la política exterior* (Buenos Aires, 2005).

[38] Stephen H. Haber, *Crony capitalism and economic growth in Latin America : theory and evidence* (Stanford, CA, 2002). p. xv

which enjoy particular protection through the government. Income inequality is also bound to rise between economically powerful groups with access to the government and the rest of society. Since the commitment to the protection of property rights is based on personal contacts and not on the rule of law as in countries with limited government, it is also much weaker. A change in government – either through elections or unconstitutional means – destroys the commitment to the protection of property rights.

This study concludes that the 1990s and the crisis of 2001 were not a break with the previous dynamics of economic policy-making. The failure of the *Convertibility* to achieve permanent stability, the chaotic political and economic transition in 2001/2002, and the high degree of corruption in Argentina at the turn of the 21st century has to be understood as both a consequence of two decades of policy-making, which followed a short-term logic based on the desire to avoid an imminent crisis at the cost of an even worse crisis in the future, and a continuation of this same logic.