2

What Went Wrong in Argentina

Several factors contributed to the remarkable deterioration of Argentina from an apparent paragon of economic reform and stabilization in 1997–98 to the tragedy now unfolding in that economy. If Argentina had a more flexible economic system, especially in its labor markets, its economy would have been more able to adapt to the rigors of the Convertibility Plan; unemployment would have been lower; growth would have been stronger; fiscal deficits would have been smaller; and interest rates would have been lower because creditors would have had more confidence in the capacity of the Argentine government to service its obligations.

Moreover, if the US dollar had not been so strong in recent years, Argentina would have had a more competitive exchange rate vis-à-vis its important European trading partners, contributing both to somewhat better growth and a better balance of payments. If Argentina had not suffered the external shock from the collapse of Brazil's crawling-peg exchange rate policy, one of the important causes of Argentina's recession during the period 1999–2001 would have been removed; and this would have had favorable consequences in several important dimensions. Or if Argentina had decided in 1997 or 1998 that the Convertibility Plan had fulfilled its purpose and the time had come to shift to a more flexible regime for exchange rate and monetary policy, it might have been better able to manage the difficulties of 1999–2001. In sum, if things had broken more in Argentina's favor, this surely would have helped to preserve the success and avoid the tragedy of Argentina's stabilization efforts.

An Unsustainable Fiscal Policy

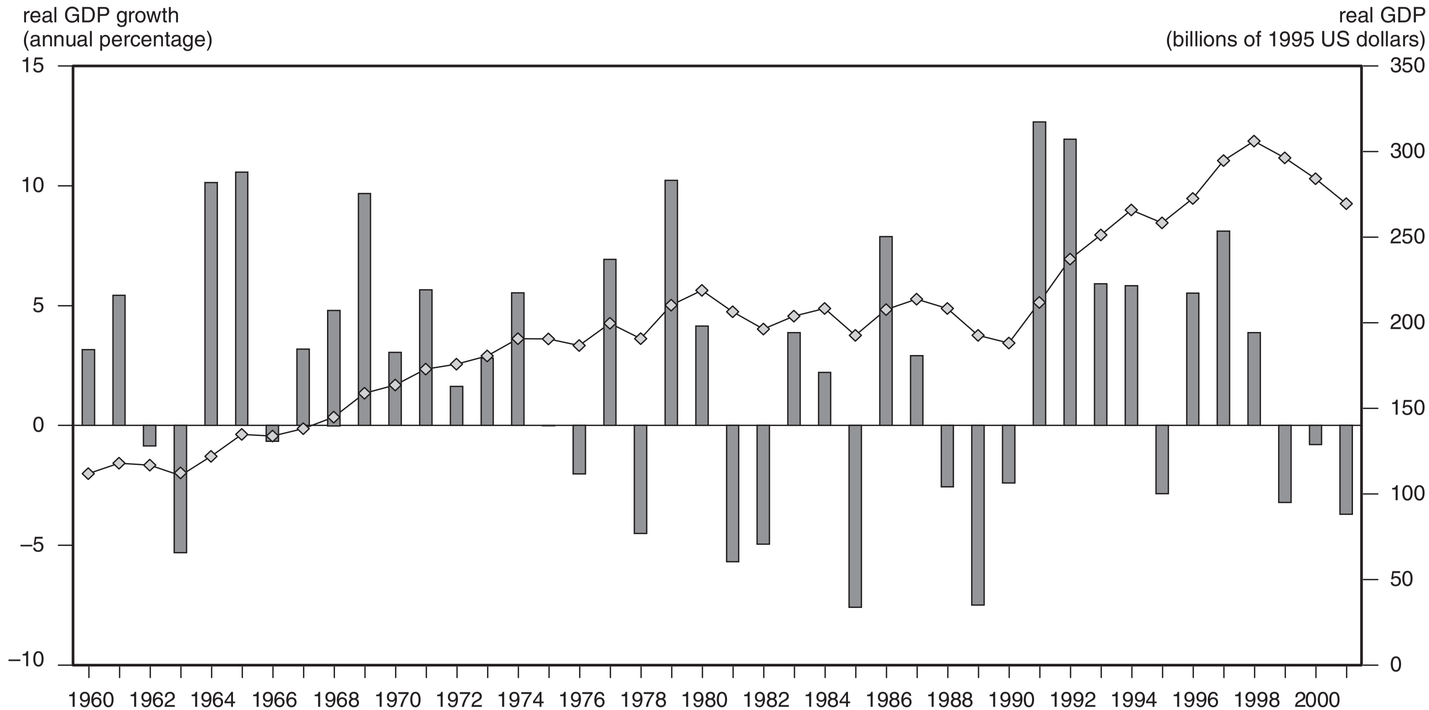
Enumerating the many things that contributed to Argentina's tragedy, however, should not obscure the critical, avoidable failure of Argentine economic policy that was the fundamental cause of disaster—namely, the chronic inability of the Argentine authorities to maintain a responsible fiscal policy. This is an old, sad story for Argentina. To satisfy various political needs and pressures, the government (at all levels) has a persistent tendency to spend significantly more than can be raised in taxes. When the government can finance its excess spending with borrowing, it borrows domestically or internationally from wherever credit is available. When further borrowing is no longer feasible (either to finance current deficits or roll over outstanding debts), recourse is found in inflationary money creation and/or explicit default and expropriation of creditors.

This is what happened during the presidency of Raul Alfonsin, culminating in the hyperinflation of 1990. With some differences in the details but none in the central substance, it is also what happened in the events that culminated in several earlier financial crises during the preceding 50 years. Thus, in the management of its fiscal affairs, the Argentine government is like a chronic alcoholic—once it starts to imbibe the political pleasures of deficit spending, it keeps on going until in reaches the economic equivalent of falling-down drunk.

This is what happened again during the past decade—and on a scale that surpassed even Argentina's past accomplishments in the dubious domain of fiscal irresponsibility. To appreciate what happened, it is useful to recall that the 1980s were a very poor decade for the Argentine economy; see figure 2.1. Indeed, the index of real GDP reached its peak for the decade in 1980, then declined by 10 percent by 1985, and subsequently recovered to just below its 1980 peak in 1987. A deep recession followed, amid financial instability that culminated in the hyperinflation of 1990, with real GDP ultimately falling more than 10 percent below its 1987 level. The inflation at the end of the decade wiped out much of the domestic currency debt of the Argentine government, leaving the dollar-denominated external debt as the bulk of the $80 billion face value of debt outstanding in 1990. The face value of the debt was reduced by about $10 billion in the Brady bond restructuring of early 1993. This left the Argentine government with a debt-to-GDP ratio of 29 percent in 1993.

The Convertibility Plan was introduced at the start of April 1991. As is often the case with exchange-rate-based stabilizations, it helped to bring both a precipitous reduction of inflation, down to the low single digits by 1993, and a remarkable rebound in economic activity, with the index of real GDP rising by 28 percent cumulatively between 1990 and 1993. It is not surprising, with such a spectacular recovery of the economy, that the Argentine government was able to maintain a fiscal policy that avoided increases in the outstanding stock of government debt. However, the

Figure 2.1 Real economic indicators for Argentina, 1960–91



Note: The bars trace real GDP growth (left axis) and the line traces real GDP (right axis).

Sources: IMF *World Economic Outlook* database and Economic Ministry of Argentina.

Table 2.1 Selected economic indicators for Argentina, 1993–98

Indicator	1993	1994	1995	1996	1997	1998
GDP (billions of US dollars)	237	257	258	272	293	299
Real GDP (percent change)	5.7	5.8	–2.8	5.5	8.1	3.9
Central government budget balance (percent of GDP)	0.9	–0.5	–1.4	–2.2	–1.6	–1.3
Consolidated government budget balance (percent of GDP)	–0.2	–1.7	–3.4	–3.3	–2.1	–2.1
Total public debt (percent of GDP)	29.2	31.1	35.9	37.7	38.9	41.4

Sources: Nominal GDP and percentage change in real GDP were calculated by the author from data in the IMF *International Financial Statistics Yearbook 2001*; other data are from IMF Press Release 96/15, April 12, 1996, and from IMF Public Information Notice 00/84, October 3, 2000.

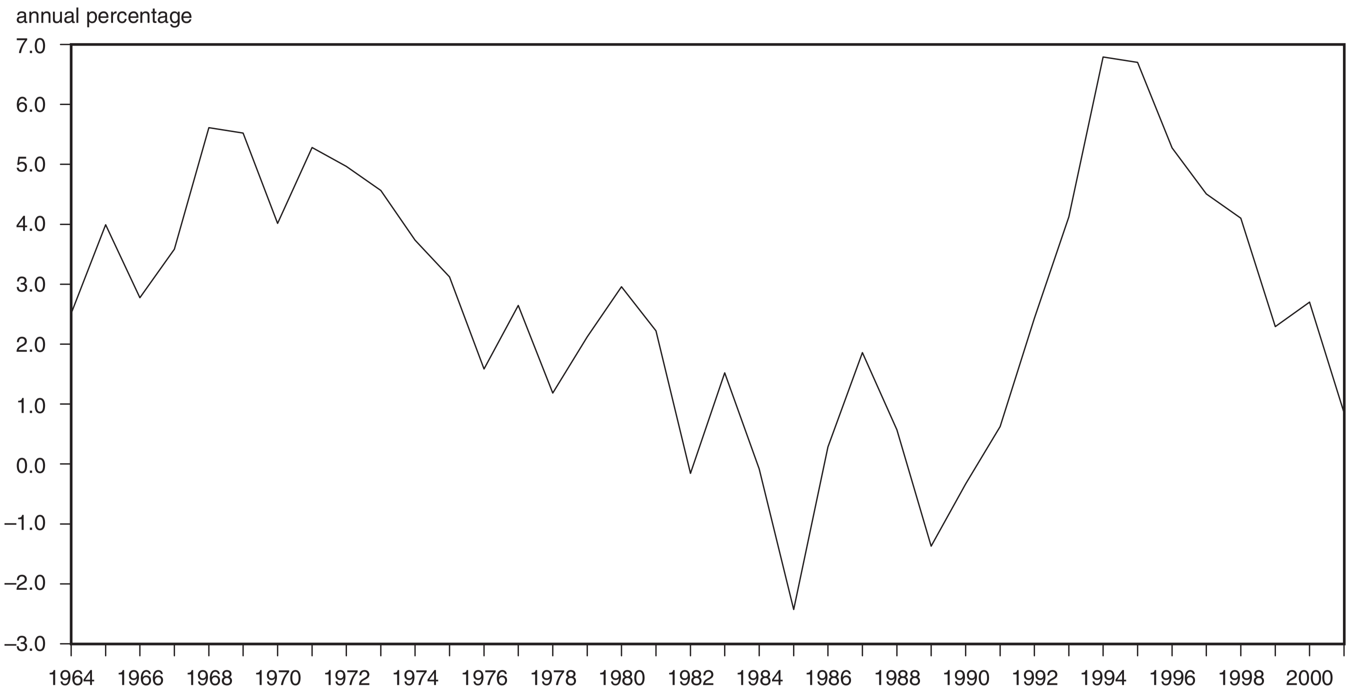
growth rates of the Argentine economy during the initial years of recovery from the disaster of the 1980s were clearly not sustainable, and the real test of Argentine fiscal policy would come when economic growth slowed to a more sustainable pace—as occurred between 1993 and 1998.

Table 2.1 presents some relevant indicators. Using the annual average data on which this table is based, the change between 1993 and 1998 corresponds essentially to the change during the five years from mid-1993 (after the Argentine economy was past the initial stage of very rapid recovery) to mid-1998 (before the Argentine economy fell into the recession at the end of the decade). This five-year period includes the sharp recession associated with the tequila crisis of 1995, as was reflected in a 2.8 percent year-over-year decline of real GDP between 1994 and 1995. Otherwise, however, the Argentine economy enjoyed quite strong growth, as well as very low inflation, during this period.

Indeed, notwithstanding the tequila crisis recession, Argentina's real GDP advanced at an annual average rate of 4.4 percent between 1993 and 1998. Aside from brief growth spurts in recoveries following financial crises, this growth record was by far the best performance of the Argentine economy since the 1960s, as is illustrated by the real GDP growth of the Argentine economy on a five-year moving average basis; see figure 2.2. With the GDP deflator rising less than 3 percent cumulatively between 1993 and 1998, the rise in nominal GDP was only modestly larger than the rise in real GDP, but it still recorded a solid cumulative gain of 26 percent between 1993 and 1998.

How was Argentine fiscal policy performing during this period of generally superior economic performance? The central-government budget balance (as a share of GDP) was the measure usually given greatest importance in International Monetary Fund programs. The central-government budget recorded a small surplus in 1993 and was in moderate deficit thereafter. Taken at face value, these budget results do not look too bad, espe-

Figure 2.2 Real GDP growth for Argentina (5-year moving average), **1964–2001**



Sources: Economic Ministry of Argentina and author's calculations.

cially if one recognizes that the tequila-crisis recession tended to boost the deficit in 1995–96.

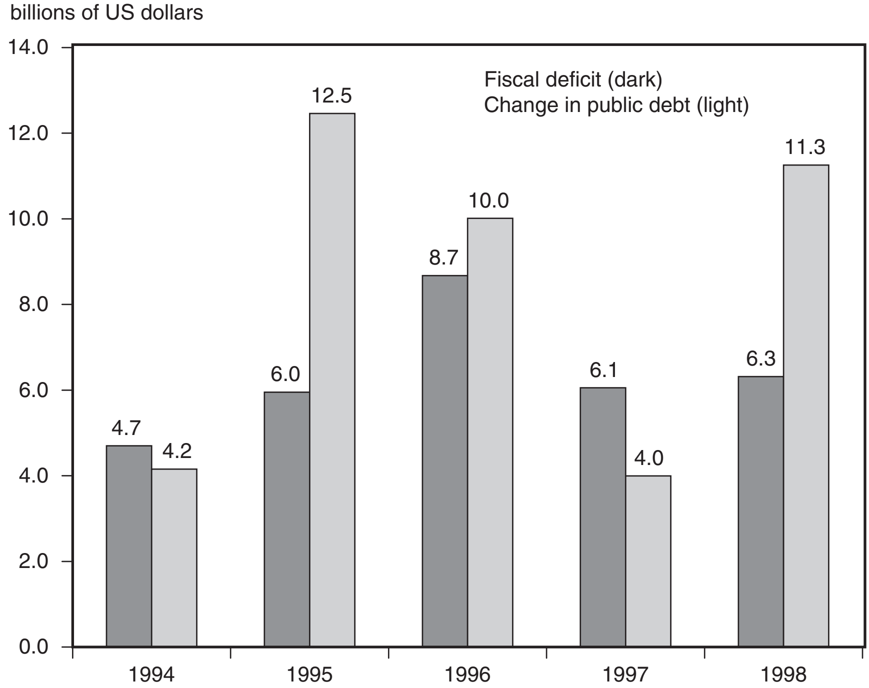
However, even restricting attention to the central government, the fiscal outcome in these generally high-growth years was significantly worse than it initially appears. From 1993 through 1998, the Argentine central government realized $3.1 billion of nonrecurring revenues from the proceeds of privatization and another $1.4 billion of capital account revenues that offset what would otherwise have been an increase in the government debt of another 2 percent of GDP.

More important, the Brady bond restructuring involved a substantial back-loading of interest payments. This is reflected in the fact the central government's interest payments on its external debt rose from $2.6 billion in 1993 to $6.4 billion in 1998. A modest part of this nearly $4 billion increase in interest expense is attributable to increases in the stock of debt between 1993 and 1998; but most of it reflects deferral of interest expense that is effectively a disguised form of government borrowing. And the further increase in interest expense on the external debt up to $10.2 billion by 2001 also partly reflects the effects of deferring earlier interest expense.

Moreover, many of Argentina's fiscal problems (particularly in the 1990s but also at earlier times) arose from inadequate fiscal discipline in the provinces, for which the central government ultimately had to take responsibility. Indeed, the Argentine system—enshrined in the Constitution and in decades of practice—was fundamentally one in which the provinces retained much of the initiative and incentive for public spending, but the responsibility for raising of revenue and payment of debt was passed off largely to the central government. The operation of this system of fiscal irresponsibility is reflected in the figures for the consolidated government budget balance, which incorporates all levels of government. Every year the budget balance for the consolidated government is significantly worse than for the central government alone.

If public-sector borrowing in a given year corresponded to the consolidated government deficit in that year, as one might naively expect from standard accounting principles, then the cumulative increase in public debt during several years would correspond to the cumulative consolidated government deficit during those years. In fact, the ratio of total public debt to GDP in Argentina rose from 29.2 to 41.4 percent between 1993 and 1998—an increase in the debt-to-GDP ratio of 12.2 percentage points. This looks quite close to the sum of the ratios of consolidated budget deficit to GDP during this period—either 12.8 percent including 1993 or 12.6 percent excluding 1993. However, the denominator in the ratio of debt to GDP, nominal GDP, rose 26 percent between 1993 and 1998; and this should have depressed the gain in the debt-to-GDP ratio by about 7 percentage points below the sum of the deficit-to-GDP ratio results for these years. Why not? Because the Argentine public sector engaged in a good deal of borrowing that was not included in the budget; see figure 2.3.

Figure 2.3 Fiscal deficit and change in public debt



Source: Economic Ministry of Argentina.

For some purposes, such as judging the likely effect of deficit spending on aggregate demand, it may be appropriate to exclude some components of public-sector borrowing from a relevant measure of the budget deficit. To assess overall budget discipline and fiscal sustainability, however, pubic debt is public debt, and all of it counts. Thus, at the bottom line, the fiscal results for the Argentine public sector during 1993 to 1998 show an increase in the debt-to-GDP ratio of 12 percentage points. If Argentine fiscal policy produced this large an increase in the debt-to-GDP ratio during a period of superior economic performance, what might it reasonably be expected to produce in less favorable circumstances?

Indeed, as was noted above, Argentina's fiscal performance in 1993–98 was actually worse than is suggested by this rhetorical question. During this period, Argentina's fiscal performance benefited from the Brady bond deal in terms of the back-loading of interest payments, as well as the Argentine government's receipt of significant privatization and other capital revenues that were fully counted on budget. *In sum, during the* *period 1993–98, when the Argentine economy was generally performing very well and the Argentine government was receiving substantial nonrecurring revenues from privatization and enjoyed other temporary fiscal benefits, the public-sector debt-to-GDP ratio nevertheless rose by 12 percentage points. This clearly was not an adequately disciplined or sustainable fiscal policy.*

Because most industrial countries have government debt-to-GDP ratios above 50 percent and some above 100 percent, it might be asked why a debt-to-GDP ratio of just above 40 percent was worrying for Argentina. There are at least five important reasons.

First, unlike some industrial countries that successfully carry much higher debt-to-GDP ratios, Argentina has had little success in raising tax revenues (including social security contributions) of more than 20 percent of GDP, compared with nearly 50 percent of GDP in several European countries. Indeed, in Argentina, the provinces are perennially in deficit and, from time to time, have called on the central government to assume responsibility for their debts. Thus, as a practical matter, any revenue of the provinces is committed to spending and little of it is likely to be available for debt service. This means that the tax base that realistically might be available to pay debt service is the tax revenue of the central government, less the substantial funds that legally must be transferred to the provinces.

Second, with most of its government debt denominated in foreign currency and with much of this debt held externally, Argentina faced the dual challenge of persuading creditors that it was capable both of raising sufficient fiscal revenues to service its debt and of being able to convert these revenues into foreign exchange with an exchange rate that was rigidly pegged to the US dollar. In addition, the Argentine private sector had significant external foreign-currency debt which required foreign exchange for its servicing. Indeed, Argentina's total external debt rose massively from $62 billion at the end of 1992 to $142 billion by the end of 1998—more than doubling during a period when Argentina's nominal GDP rose by about a quarter.

Traditionally, export receipts are taken as a measure of the foreign exchange earnings that might be available to service a country's external debts. As is the case with many countries that substantially reduce their barriers to external trade, Argentina's trade expanded rapidly from 1993 to 1998, with both exports and imports doubling. The rapid expansion of exports helped to limit the rise in the ratio of external debt to exports. Nevertheless, at more than 400 percent, this ratio was exceptionally high relative to that of most countries—at a level that often signals a substantial risk of an external financing crisis that can only be resolved through debt restructuring.

Third, it is not just the level of the government debt (relative to GDP or tax revenues or exports) that matters; it is also how the debt has been behaving. If Argentina had stabilized its debt-to-GDP ratio for some time, under both good and bad economic conditions, then a debt-to-GDP ratio around 40 percent might not have been so worrying. However, a debt-to-GDP ratio that rose from 29 to 41 percent of GDP during generally good economic times was surely a worrying signal of incapacity to maintain reasonable fiscal discipline, especially for a country with a record of persistent difficulties in this area.

Fourth, emerging-market countries in general, and Argentina especially, was potentially vulnerable to external economic shocks that might impair fiscal sustainability at debt-to-GDP ratios far lower than those of industrial countries. Indeed, this is what happened. Events surrounding the collapse of Brazil's crawling-peg exchange rate in early 1999 had important negative spillovers for Argentina. Real GDP contracted 4 percent between 1998 and 2000. The price level also fell, with the result that nominal GDP dropped 4.9 percent between 1998 and 2000. In this weak economic environment, despite some efforts at fiscal consolidation, the budget deficit widened. With public debt rising and nominal GDP falling, the debt-to-GDP ratio jumped from 41 percent in 1998 to 50 percent in 2000. With recession and deflation continuing in 2001, the economic and political environment for fiscal consolidation was clearly becoming even more difficult; and there was real reason to fear that the public debt was on an unsustainable upward spiral.

Fifth, as an emerging-market country with substantial external debt, Argentina was clearly vulnerable to changes in financial market sentiment. Aside from brief interruptions during periods of general market turmoil, Argentina would probably be able to maintain necessary access to external financing—as long as financial markets believed it was a good credit risk. However, its long record of periodic financial crises and debt restructurings was not reassuring. If market sentiment ever shifted to an expectation of significant risk that Argentina might default, its market access would be cut off and that expectation would soon become self-fulfilling.

The Fund and Fiscal Policy

What was the International Monetary Fund's role in the fiscal failures of the Argentine government? As was noted above, aside from showing some understanding about the difficulties of tightening fiscal policy in the midst of the tequila crisis, the Fund clearly did not encourage the Argentine government to run up large deficits and build up its debt to the point of nonsustainability. However, the Fund did fail to press the Argentine authorities as hard as it could have and should have to maintain a more prudent fiscal policy. Why not?

In the period from 1991 through the start of the tequila crisis, fiscal policy was not the Fund's most urgent concern for Argentina. The excess of government spending over recurring revenues was modest and was financed partly by privatization receipts and other sources that did not lead immediately to increases in debt; and the level of government debt was not threatening. The central concern was that the exchange rate, which was pegged at parity to the US dollar in nominal terms, was becoming overvalued in real terms because inflation in Argentina (although dramatically reduced) remained above US inflation. Also, as the Argentine economy recovered from the economic impact of hyperinflation, domestic expenditure rose sharply, contributing to a growing current account deficit. The key concern was that if the capital flows to Argentina that were financing the current account deficit began to reverse or even slow down significantly, a foreign exchange crisis would likely ensue.

Indeed, I recall expressing the concern in the autumn of 1994 that a foreign exchange crisis starting in Argentina would probably also take down the Mexican peso. It happened the other way around; the tequila crisis started with the devaluation of the Mexican peso in mid-December 1994 and spread quickly to Argentina. The Fund supported Argentina's successful efforts to maintain its exchange rate peg in that crisis. The policy response included a moderate tightening of fiscal policy, intended both to contribute to a reduction in the current account deficit and to reassure Argentina's creditors.

When the actual fiscal deficit began to exceed the program targets during 1995 because of an economy that was weaker than expected, the Fund insisted on some further tightening measures; but it showed unusual flexibility (by past Fund standards) in allowing an upward revision of the deficit target. In my view, this was the right approach. It did not make sense to insist on substantial further fiscal tightening to stay within the original target allowed for the fiscal deficit in the face of a weaker-than-projected economy, provided that the confidence of Argentina's creditors was reasonably well maintained.

Unfortunately, however, the Fund's flexibility in allowing an upward revision of the fiscal deficit target in the face of a weaker-than-expected economy was not applied symmetrically. Starting in late 1995, the Argentine economy began three years of very rapid recovery, significantly more rapid than was assumed in setting the (nominal) fiscal targets for the Fund-supported programs in this period. Normally, one should have expected that the Argentine government's fiscal deficit would have come in well below the permitted target—which, as always in Fund programs, was clearly defined as a ceiling for the fiscal deficit that was not to be exceeded and not as an objective to be hit exactly.

However, the deficit never came in well below the target; generally it was just below or even slightly above the permitted limit. Indeed, during the period from 1995 through 1998, the deficit of the Argentine government was within the quarterly limits prescribed at the beginning of each year under the IMF-supported program less than half of the time. More than half of the time, waivers were granted for missed fiscal performance criteria, or these criteria were met but only after they had been revised upward, or the violations (at the ends of some years) were simply ignored by the Fund and effectively swept under the rug. During 1995, when the recession turned out to be steeper than assumed at the start of the Fund-supported program, there was plausible reason to grant waivers and make upward adjustments to the deficit limits, rather than to try to force sharp additional fiscal tightening to meet the originally prescribed program targets.

At other times, however, when the Argentine economy was generally growing strongly, it is difficult to understand why the Fund did not make active use of its conditionality to press the Argentine government to maintain a more responsible fiscal policy. Rather, to avoid embarrassing the Argentine authorities, the Fund placed little emphasis on Argentina's transgressions of the initially specified fiscal targets, especially in public. And the fiscal targets were significantly less demanding than they appeared to be (even allowing for stronger-than-expected economic growth), because they conveniently ignored substantial amounts of government borrowing that were viewed by the Argentines as off budget.

All of this was quite different from what happens when the Fund wants to make a point and to press a program country to strengthen its policies and, as a consequence, there are delays in completing program reviews and in concluding negotiations for new programs or the later phases of established programs. In sum, the failure of the Argentine government to maintain a sufficiently prudent fiscal policy that effectively restrained the increase in public debt when the Argentine economy was performing well was surely a key—indeed, arguably, the key—*avoidable* policy problem that ultimately contributed to the tragic collapse of Argentina's stabilization and reform efforts. The Fund's tepid efforts to press the Argentine government to maintain a more responsible fiscal policy appear to be more a part of this problem than a part of its solution.

In mitigation, it should be noted that after successfully navigating the strains of the tequila crisis, Argentina was widely seen as one of the most successful emerging-market economies. Its economic policies were widely praised in the official international community. Indeed, as a hero of successful economic stabilization and reform, President Menem was accorded the unique honor of appearing jointly with US President Bill Clinton to address the IMF-World Bank Annual Meetings in Washington in October 1998. Private financial markets roared their approval as well by financing large amounts of Argentine borrowing at attractive spreads relative to most other emerging-market debtors, with the Emerging Markets Bond Index Plus spread for Argentina typically running well below the average spread for all emerging-market borrowers from 1997 through 1999.

These favorable assessments reflected the important successes that had been achieved by Argentina's stabilization and reform efforts in the 1990s, after many decades of dismal policies and performance. Indeed, with the collapse into financial crisis of many previously successful Asian emerging-market economies in 1997–98 and the developing difficulties in Brazil and Russia, Argentina stood out as one clear success story. With the Fund under widespread criticism (rightly or wrongly) for its involvement in Asia, it was particularly gratifying to be able to point to at least one important program country where the Fund appeared to be supporting successful economic policies. In this situation, there was probably even more than the usual reluctance for the Fund to be the skunk at the garden party by stressing the accumulating failures of Argentine fiscal policy.

Convertibility and Bust

The Convertibility Plan adopted in early 1991 played a central role both in the success of Argentina's stabilization and reform efforts during the past decade and in their ultimate tragic collapse. The essential objective of the plan was to end decades of financial and economic instability by ensuring that Argentina would have sound money. This was to be accomplished by linking the value of the domestic currency at parity to the US dollar, with the guarantee that pesos could be exchanged for dollars at will. The Argentine central bank was given independence from the government, under the mandate that it maintain convertibility by holding dollar reserves against its domestic monetary liabilities (currency and commercial bank reserves).

This 100 percent reserve requirement could be relaxed to 80 percent in emergency situations declared by the government, and the central bank could then hold up to 20 percent of its assets in government debt. Otherwise, the central bank was prohibited from printing money to finance the government. These features were meant to provide credible assurance that the persistent Argentine problem of rapid inflation generated by monetization of fiscal deficits could not be repeated under the Convertibility Plan.

Beyond the Convertibility Plan itself, the Argentine government undertook important measures to assure a sound banking system, especially after the tequila crisis. Commercial banks were privatized, and most of these banks were taken over by large foreign banks based in Spain and the United States. Commercial banks were required to be well capitalized and prudently managed; and, after 1995, they were encouraged to arrange foreign lines of credit that could be drawn in the event of a foreign exchange crisis. Commercial banks could do business in either dollars or pesos, but they generally maintained a reasonable balance between assets and liabilities denominated in the two currencies; the banks were further protected by the government's guarantee of convertibility of pesos into dollars. (The strength of the banks, however, would be seriously undermined if the government defaulted on the substantial volume of claims held by banks, or if the Convertibility Plan collapsed and led to defaults by Argentine borrowers on their dollar-denominated loans from banks.)

As is often the case with exchange-rate-based stabilization efforts, particularly from situations of hyperinflation, the Convertibility Plan performed very well initially. With the new peso rigidly pegged to the dollar, the inflation rate collapsed from 4,000 percent a year to single digits within three years. With reasonable assurance of monetary stability, the Argentine economy recovered rapidly from the economic devastation wrought by hyperinflation. As was noted above, however, the real exchange rate appreciated and the current account moved into a significant deficit; see figures 2.4 and 2.5. This was a pattern common in exchange-rate-based stabilizations, often leading to foreign exchange crises and the collapse of stabilization efforts. The Fund was rightly concerned that this problem might also engulf Argentina's Convertibility Plan.

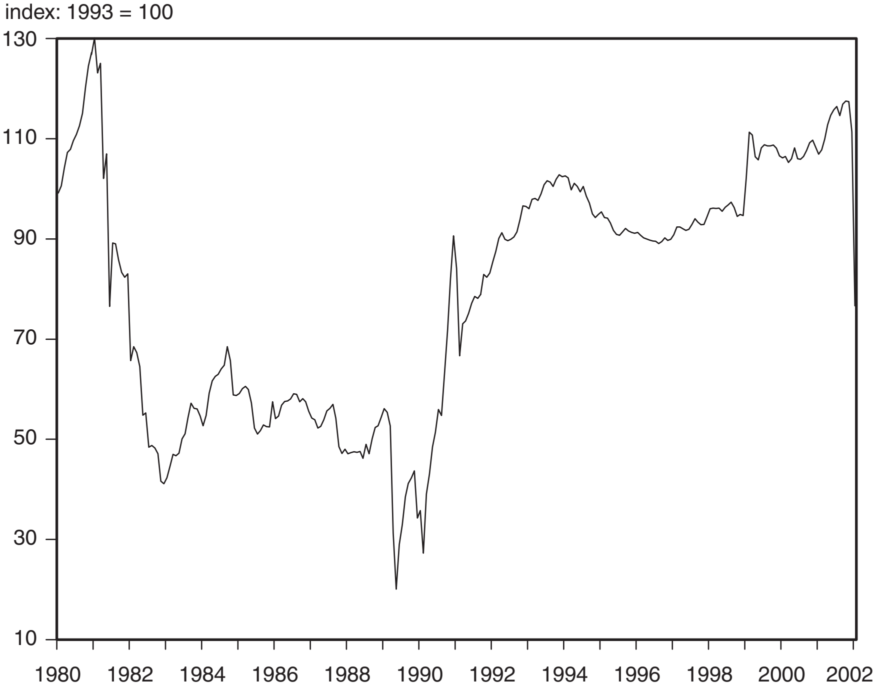
The crucial test of the Convertibility Plan came in the tequila crisis of 1995. Here, the strengths of the plan, in contrast to many efforts at exchange-rate-based stabilizations, made themselves apparent. The government used the emergency provisions to relax the constraint of 100 percent foreign-currency reserves, and this allowed the Central Bank of Argentina some room to avoid as tight a monetary policy as would otherwise have been forced by the loss of reserves. Nevertheless, monetary conditions were tightened considerably and interest rates rose to substantial premiums over corresponding US rates.

Commercial banks came under significant pressure as high interest rates and a weakening economy undermined credit quality, and deposits flowed out of the banking system because of fears of bank failures or possibly of a break in the exchange rate peg. A few small banks did fail, but the banking system as a whole, notably all the large banks, survived the pressures of the crisis—crucial evidence of both the importance and the success of the measures that had been undertaken to strengthen the banking system.

In addition, Argentina had good luck externally: the US dollar depreciated sharply in early 1995, improving Argentine competitiveness in European markets; the Brazilian real strengthened markedly, improving Argentine competitiveness relative to that key trading partner; and interest rates in US capital markets fell back as it became clear that policy tightening by the US Federal Reserve was at an end and a shift toward easing (which began in the summer of 1995) might be in store. Were it not for the substantial improvements in bank soundness and for the external good luck, the Convertibility Plan might not have survived the tequila crisis.

After the test of the tequila crisis was successfully passed, some might argue that the time was ripe for an orderly exit from the Convertibility Plan. The main benefits of an exchange-rate-based stabilization had already been achieved, and many of the foundations for monetary stabil-

Figure 2.4 Real effective exchange rate, Argentina, 1980–2001



Note: The real effective exchange rate index is based on the consumer price index.

ity without an exchange rate peg had been put in place. Argentina was surely not part of an optimum currency area with the United States, because the Argentine economy was subject to much different shocks from the US economy and the monetary policy appropriate for Argentina need not generally coincide with that appropriate for the United States. Moreover, by this stage, Brazil was Argentina's largest trading partner, and a potential collapse of Brazil's exchange-rate-based stabilization effort was an important risk for Argentina and its Convertibility Plan. Clearly, looking back with the knowledge of recent developments, one would have to say that an earlier, more orderly exit from the Convertibility Plan would have been preferable to the present tragedy.

On the other hand, there were sound reasons for the Fund to continue to support the Convertibility Plan in the years after the tequila crisis. The Argentine government was determined to preserve the plan (or possibly even consider a move to full dollarization), and the plan undoubtedly enjoyed wide and deep popular support in Argentina. After enduring decades of financial instability, punctuated by occasional financial crises, most Argentines were particularly appreciative of the stability that had

Figure 2.5 Argentina's current account balance, 1980–2001

Source: Economic Ministry of Argentina.

been produced by the plan. Some, of course, recognized that the constraints imposed by the plan had important costs. In the tequila crisis, unemployment rates rose substantially, and they remained relatively high in the subsequent recovery. There was great pressure to bring down domestic costs, particularly in industries exposed to external competition; and this resulted in downward adjustments in nominal and real wages. Workers in the affected industries, many labor union leaders, and some politicians (especially Peronists) were not happy. However, to the extent that Argentines more generally were concerned with these problems, they did not necessarily attribute them to the Convertibility Plan; and, in any event, they were not inclined to abandon the plan with the risk that implied to financial stability and to the value of their own savings.

Indeed, among the supporters of the Convertibility Plan, there were those who saw that one of its important benefits was to force painful but necessary changes on the Argentine economy and society. After decades of protectionism and other government interventions to support specially favored sectors of the economy, the institutions of Argentine labor markets needed to become more flexible and the Argentine economy needed to become more efficient. From this perspective, the Convertibility Plan, which enjoyed broad and deep political support, provided the political leverage to achieve these desirable results.

At the Fund, sympathies undoubtedly lay with those who wanted to reform the Argentine economy in directions that would better allow it to reach its full productive potential. And the Argentine authorities who wished to preserve the Convertibility Plan appeared to be inclined in this direction. This, however, is not what induced the Fund to support the Argentine authorities in their decision to attempt to preserve the plan. Rather, in keeping with its Articles of Agreement (especially Article IV, Section 2), the Fund was required to support the basic policy strategy chosen by the duly constituted authorities of Argentina, as long as that strategy had at least a reasonable chance of success.

Until quite recently, perhaps as late as mid-2001, it was not clear that the Convertibility Plan was doomed to collapse in a catastrophic crisis. If sufficiently forceful measures had been undertaken early enough (particularly to reduce the fiscal deficit), the difficulties of the Argentine economy during the period 1999–2001 would not have been entirely avoided, but the outcome of the present crisis could have been much more favorable under plausible alternative scenarios that included preservation of the plan.

One might argue that Argentina would be better off in the long run without the Convertibility Plan than under this plausible alternative scenario. But the fundamental choice of Argentina's monetary policy framework and exchange rate regime was a choice for the duly constituted government of Argentina. The Fund could advise on the relative merits of different policy regimes and their relevance to Argentina. However, under the principles that govern the behavior of the International Monetary Fund as a voluntary association of sovereign members, the basic choice of regime is a decision of the member—at least up to the point where the chosen regime has no reasonable chance of success under policies that could plausibly be implemented.

Thus, though an independent observer might reasonably conclude that the rigidities of the Convertibility Plan deserve relatively more weight, and the failures of Argentine fiscal policy correspondingly less weight, in the blame for the tragedy that ultimately befell Argentina, this is not the relevant perspective from which to view the role of the Fund. For the Fund, the relevant question was—given the choice of Argentina to adopt and maintain the Convertibility Plan—what other policies were necessary to make the stabilization and reform effort a success. Given the plan, failure to maintain a sufficiently prudent fiscal policy would likely prove a fatal error. The Fund, having accepted the Convertibility Plan, had the responsibility to press very hard to avoid this fatal error.