

Title:

Argentina's Economy in a Nutshell

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Summary:

A brief history of Argentina's enigmatic economy, from the roots of wealth in the 19th century to the current recovery.

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Article Body:

Argentina's Economy

Contrary to conventional economic wisdom, rich countries tend to stay rich and poor countries tend to stay poor. The exceptions tend to be those "economic miracles", like Japan, that have lifted themselves from the ranks of the poor into the ranks of the economic elite.

Argentine economic history stands in stark contrast to that pattern. In the early 20th century, Argentina was one of the world's richest countries, with a higher per capita income than that of France or Germany. And while Argentina still enjoys many of the fruits of wealth, like a highly educated population and a modern infrastructure, income per head had fallen to a meager 43% of the rich-world average by 1987. In the wake of the economic collapse of 2001-2002, over half of the population fell under the poverty line, and over a quarter were classified as indigent.

Roots of Wealth

From 1880 to 1914, Argentina experienced a massive population boom as European immigrants came in search of land to settle and make productive. Many ended up in the fertile pampas region around Buenos Aires, and with the help of British-built rail links, an export economy was soon in full swing. On top of an already vibrant wool and hide industry, Argentines were soon exporting corn, wheat, and flour to hungrily industrializing European cities. But the real money was in meat exports, made possible by the invention of the refrigerator ship in 1876; Argentina has been famous for beef ever since.

The Long Decline

While Argentina became rich, Buenos Aires made the transition from sleepy backwater to thoroughly modern city—"The Paris of the South"—boldly leading Latin America into the new century. Unfortunately, the 20th century failed to meet the high hopes of any Latin American nation, least of all Argentina's.

The trouble started with the great depression of the 1930s, which kicked off a downward spiral into economic and political instability which lasted for the next sixty years. A military coup in 1930 was the first of many, and the civilian governments that occasionally emerged were scarcely more competent than the military juntas.

The government of Juan Domingo Peron (1946-1955) left an indelible mark on the Argentine economy, making it less open to foreign trade, nationalizing key industries, and greatly expanding the benefits of workers. While Peron was somewhat able to redress the gross inequalities permeating the country, he also left a legacy of state control of the economy, stifling private entrepreneurship and creating an environment ripe for corruption.

In the post-Peron years, governments increasingly relied on deficit spending to smooth out social problems. To cover the difference between spending and tax revenue, they simply printed more money, creating inflation. By the 1980s, inflation was out of control; in 1989 the inflation rate was over 5,000 percent.

The 90s Boom

Enter Domingo Cavallo, who stepped in as Carlos Menem's economy minister in 1991. The keystone in Cavallo's economic recovery plan was to curb inflation with something called convertibility, a legal guarantee that Argentine pesos could be exchanged for US dollars at a ratio of 1 to 1. Inflation was tamed, and investor confidence soared as Cavallo steadily opened up the economy to foreign trade and capital. In tune with the free market fervor of the 1990s, the more inefficient state-controlled enterprises were sold—sometimes to Menem's friends at bargain prices.

Still, Argentina was clearly getting richer. The gross domestic product grew briskly from 1991 to 1998, with the exception of 1995, when Mexico's financial crisis shook Latin America. Much of the new wealth was accruing to the country's elites, but the poor and the middle class were also becoming better off. The Argentine debacle was starting to look like the Argentine miracle; Carlos Menem became an international celebrity and Argentina a poster child for liberal

economics.

The Crisis of 2001-2002

Ironically, Argentina's blatant disregard for a fundamental tenet of "neoliberal" economics proved to be a decisive factor in its demise. As the 90s boom roared on and the government's tax take soared, fiscal discipline would suggest setting aside a "rainy day" fund for the event of a recession—because recessions are inevitable in any economy. Instead, the money was spent and new debt was piled up even in the good years. When the economy hit a rough patch in 1999, the government found itself in an extremely difficult situation; it needed money fast and was already significantly indebted.

Luckily for Menem, his term was up and the new President, Fernando de la Rúa, was left to pick up the pieces in 2000. He could try to balance the budget by cutting spending or raising taxes, but this would exacerbate the recession and further reduce tax revenues. Faced with this catch-22, de la Rúa opted to borrow his way out, in the hope that the recession would quickly and quietly fade away. Unfortunately, this approach often leads to a downward spiral of its own, known as "explosive debt dynamics", in which investors begin to fear a default on the debt, driving interest rates up and deepening the recession, thus increasing the debt even more. This is exactly what ended up happening in Argentina's case.

As a last ditch effort, de la Rúa appointed as his economy minister Domingo Cavallo, now a national legend, in a move that electrified the country. But neither Cavallo's mystique or the IMF's haphazard intervention could stave off the coming default. As dollars started to flee Argentina, the government enacted restrictions on bank withdrawals that became known as the *corralito*, or little fence. In the public eye, this was the final straw, and massive street protests rocked Buenos Aires and other big cities, forcing de la Rúa and Cavallo to resign in shame in late December, 2001. The government had collapsed; Argentina defaulted on its debt a few days later.

One of the first acts of Eduardo Duhalde, the new president elected by congress at the start of 2002, was to discontinue the convertibility system by which the peso was linked to the US dollar. With the shortage of dollars in the country, the system couldn't be maintained; there simply weren't enough dollars to trade for pesos. Set free, the peso fell to about 4 to the dollar over the next six months, spelling ruin for those who had taken out loans denominated in dollars. Banks ceased to function as individual debtors defaulted and now-cynical savers refused to deposit money. The poverty rate soared while incomes plummeted. The Argentine financial crisis has been compared in scope to America's great crash of 1929.

After the Crisis

The very dark cloud of Argentina's collapse did have a silver lining. The peso recovered slightly and has held steady at about 3 to the US dollar, a level that makes Argentina's products (and Argentina as a travel destination) much more attractive to the rest of the world. In fact, some have argued that one cause of the crisis was the overvalued exchange rate, which made Argentine exports less competitive. The economy was growing again in 2003, and has since, fueled in part by high worldwide commodity prices. In 2005, GDP roared past its previous peak (in 1998), and many economists believe Argentina is on firmer ground than it was in the 90s owing to the fiscal responsibility of Nestor Kirchner, the current president.

Looking to the future, rising inequality is one concern deeply felt by many Argentines. The recovery has put more wealth in the hands of the wealthy, like the soy farmers leading the new export boom or those who were lucky enough to get their money out before the devaluation. On the upside, employment is up, and a fiscally solvent state will be in a much better position to help those on the bottom rungs of society climb higher.