The Influence of Interest Groups on Government

The Case of the 2001 Argentine Crisis

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Interest groups' influence on government affects economic policy making and has an impact on economic crises. Under Argentina's convertibility exchange-rate regime until its collapse in 2001, tradable-goods entrepreneurs' preferences depended on the degree to which the government offered them trade-offs either to offset the loss of competitiveness stemming from the currency peg or to exempt them from the costs of devaluation. For the nontradable sector and investors the costs of maintaining the peg to the dollar were always less than those entailed in abandoning the regime. While the fiscal and external inconsistencies of convertibility reduced the preference of the International Monetary Fund for maintaining convertibility, the cost of changing it induced the Fund to continue financing the Argentine government. Moreover, the influence exerted on the IMF by the governments of countries whose businesses had been affected by the distribution of the cost of abandoning the convertibility discouraged financial collaboration by the foreign assistance organizations during the collapse.

La influencia de los grupos de interés sobre el gobierno afecta la orientación de la política económica y tiene su impacto en las crisis económicas. Durante el régimen de convertibilidad en Argentina hasta su colapso en 2001, las preferencias de los empresarios de bienes transables dependían del grado en que el gobierno les ofrecía compensaciones, sea para moderar la pérdida de competitividad derivada de la fijación o para sustraerlos de los costos de la devaluación. Para los empresarios del sector no transable y los inversores financieros los costos de mantener la fijación con el dólar resultaron siempre inferiores que los de salir del régimen. Si las inconsistencias fiscales y externas de la convertibilidad desalentaban la preferencia del FMI por mantener la convertibilidad, los costos de cambiarla indujeron al Fondo a sostener el financiamiento al gobierno argentino. Asimismo, la influencia que ejercieron sobre el FMI los gobiernos de los países cuyas empresas habían sido afectadas en la distribución de los costos del cambio de régimen cambiario desalentó la colaboración financiera de los organismos proveedores de ayuda externa durante el colapso.

Keywords: *Economic policy, Interest groups, Argentina, Financial crisis, Convertibility*

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The economic policy frameworks based on a fixed or quasi-fixed exchange rate employed in Argentina and Brazil during the 1990s promoted price stability after several decades of economic instability and high inflation. Nevertheless, hard pegs are very dependent on foreign capital inflows and lack the exchange and monetary tools to stimulate the economy and the job market and to adjust the balance of payments. They are therefore very prone to amass distortions, create imbalances, and produce inequalities. When faced with a crisis, governments then have controversial options: to maintain the fixed exchange rate, attempting to restore temporary consistency—which usually implies increasing its rigidity—at the price of a deeper recession and greater costs for a future exit, or to introduce flexibility, allowing the currency to float, at the price of a costly upset in public and private balance sheets. But in addition to affecting the economic policy's consistency and the aggregate economy outcomes, different configurations of exchange systems—fixed or flexible—produce diverging distributive effects on business and social sectors, generating winners and losers (Corden, 2000; Frieden and Stein, 2001). Thus, companies from the tradable and nontradable sectors, investors, and foreign assistance providers have special interests in influencing exchange-rate policy. This suggests that to explain economic policy-making choices we should examine the politics that produces them.

The purpose of this article is to examine the influence of business, financial actors, and international organizations in the collapse of the Argentine convertibility exchange-rate regime (a currency board that created a fixed parity between the peso and the U.S. dollar) that led to the 2001 crisis. The argument is that government decisions and convertibility dynamics throughout the 1990s produced changes in the relative weight of actors with interests in and lobbying power over economic policy and that this helps to explain the nature of the crisis. As a result, to understand the 2001 collapse I analyze the way in which the preferences and resources of these actors changed over time and the way in which the strategies they produced conditioned the government's decisions.

The paper proceeds as follows. In the next section I examine the way in which tradable-sector managers processed the progressive loss of competitiveness derived from pegging the exchange rate. In the following two sections I explore the stances and logic of the preferences of nontradable-sector managers and investors in situations of economic imbalance. I go on to describe the evolution of the needs assessment and the influence of the International Monetary Fund (IMF) on convertibility. Lastly, I summarize my findings.

THE PREFERENCES AND POWER OF THE TRADABLE SECTOR

The tradable business sector in Argentina has historically been influential in the policy process, and their place in the production structure is consistent with maintaining a relatively undervalued local currency. The literature on the political economy of economic policy decisions in Argentina has shown that the degree of concentration in the tradable-goods sector and its presence in both private and public businesses gave them decisive influence on the government during the 1990s (Etchemendy, 2001). Moreover, according to the theories about business-sector preferences (Broz and Frieden, 2006; Fernández Albertos,

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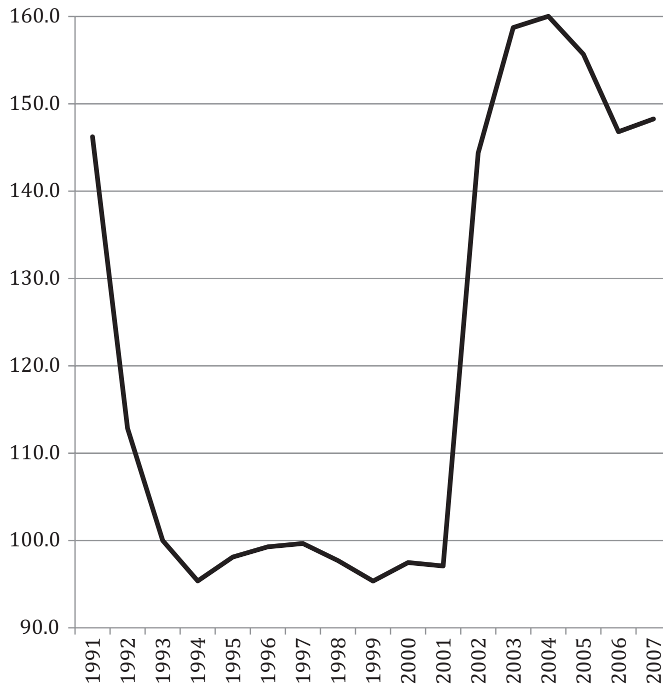

Figure 1. Relative prices, 1991–2007 (data from the Buenos Aires office of the Economic Commission for Latin America and the Caribbean).

2007), a rigid labor market like Argentina's fosters a shared interest among exporters and industries that compete with imports to preserve a relatively competitive exchange rate level. Despite the tradable sector's aversion to appreciation and loss of competitiveness, however, a government may obtain their support for a currency board like convertibility in exchange for compensation. Further, the dynamic induced by convertibility—currency overvaluation and foreign indebtedness—increases the price of collaboration of the tradable sector in either maintaining the peg or changing it.

Participation in privatizations, the expansion of activity due to stabilization, and the possibility of foreign exchange borrowing at accessible rates established a coalition of support for convertibility in the early 1990s among the larger protected tradable-goods sectors. The oligopolistic nature of investment and control by business associations (united in the Argentine Industrial Union) allowed the more influential companies to sell their support of commercial liberalization and the fixed exchange rate to the Carlos Menem administration at a high price, since they were potential losers. The government used privatizations to offer trade-offs and thus maintain the support of the companies with greater resources to the disadvantage of small and medium-sized businesses. Petroleum and steel producers obtained a reduction in competition for bidding and new concessions and participation in the privatization of public services (Etchemendy, 2001).[1]

However, the structure of relative prices induced by the currency board steadily reduced industrial prices relative to services (Figure 1)—reversing the

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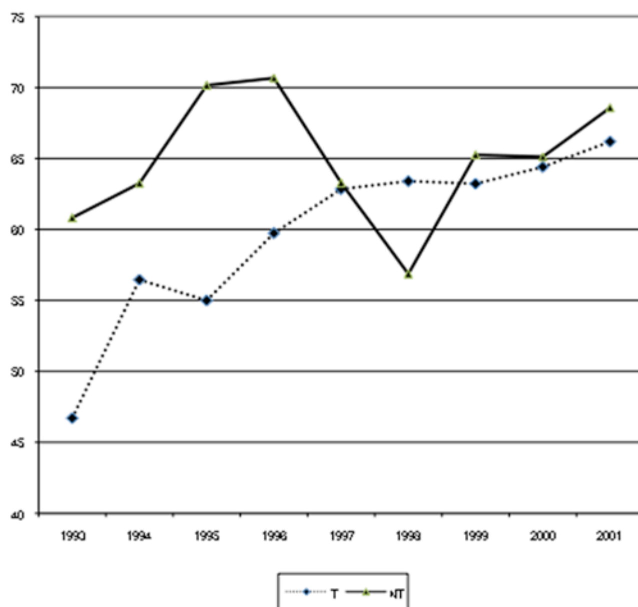

Figure 2. Median debt in dollars as proportion of total debt, tradables and nontradables, 1993–2001 (Español, 2007, based on data from the Inter-American Development Bank).

tendency of the 1980s—and caused a reconfiguration of the economy's relative profitability that negatively affected the manufacturing sector (Azpiazu, Basualdo, and Schorr, 2001; Heymann, 2000). As a result, after the benefits of the first expansive phase, support for convertibility by the more concentrated tradable-goods sector, with greater ability to exert pressure, was increasingly displayed in the tension between the limits imposed by their debt in foreign currency (Figure 2) and the degree to which fiscal devaluations and government protection from foreign competition corrected the imbalance of relative prices and maintained their profitability. The debt in dollars of the companies in this sector grew significantly throughout this period, increasing the devaluation risk of their balance sheets (Bisang, 1996). The fiscal devaluation and tariff protection packages were promoted under circumstances marked by the threat of a trade deficit (Viguera, 1998).[2]

The deceleration of economic activity in 1998 and the decrease in competitiveness produced first by the appreciation of the dollar and then by the Brazilian devaluation produced a division in the business community, which had coordinated government policy involving the whole private sector through the Group of 8 (which unified the demands of the business community—industry, exporting, agriculture, construction, trade, and banking—during that period). While during the imbalance produced by the "Tequila effect" (the flight of foreign capital triggered by the collapse of the Mexican peso in 1994) the various types of compensatory measures had been sufficient to silence questioning of the exchange regime, the loss of competitiveness with Brazil (Argentina's principal trade partner) intensified demands and pressure from the industrial sector.[3]

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At any rate, the risk of currency mismatch (different values of dollar-denominated assets and liabilities) and the government's preference for maintaining convertibility continued to act as a limit to the demands for competitiveness, which were expressed in terms of requests for tariff protection and fiscal devaluations. According to the former economy minister Roque Fernández (interview, October 2007), "the tradable-sector businesses were not asking for a devaluation because they were indebted in dollars. . . . Thus they preferred to stop imports and continue to become indebted in dollars at 7 or 8 percent." As a result, the activation of safeguards and antidumping measures, suspension of Mercosur, elimination of employer contributions, reduction of labor costs, and special taxation regimes by sector (in exchange for price reductions) were now on the agendas of Fernández, José Luis Machinea (minister during the de la Rúa administration in 2000), and later Domingo Cavallo in 2001, and many of these demands for compensation were objects of executive decisions and congressional legislation. Nevertheless, the deepening of the recession and the financial imbalances in the second semester of 2001 encouraged the industrialists to pressure for state assistance to deal with debts (Navarro, 2001) and to present in national and international forums an economic program that meant adopting "pesification"—converting dollar-denominated accounts and debts to pesos—and a floating exchange rate as the preferred public policy. The currency mismatch in bank loans—dollar debts with income in pesos—required that pesification precede the devaluation of the currency (Unión Industrial Argentina, 2001).

In summary, three phases marked the preferences of producers of tradable goods under convertibility. At the beginning (1991–1992), appreciation was slow and attributed to inertial inflation; there was no risk of a currency mismatch, and the tradable sector companies received the benefits of an increase in domestic consumption. Therefore they preferred to maintain convertibility. A second phase occurred from the end of 1992 to the Tequila crisis in 1994. In this period the risk of a currency mismatch increased (credits in dollars would have become nonpayable if there had been a depreciation), adding another very good reason for the tradable business sector to prefer maintaining convertibility. After the Tequila effect and the continual appreciation of the peso, only the above-mentioned set of compensatory measures managed to earn the support of tradable-goods businesses for convertibility. Finally, restrictions on external financing in 1999 and the government's difficulty in getting the economy out of recession—combined with a much appreciated peso—unleashed a change in preferences in favor of abandoning convertibility with trade-offs (the "pesification" of debts).

THE PREFERENCES AND INFLUENCE OF THE NONTRADABLE SECTOR

The privatization process during the 1990s increased the relative weight of the nontradable sector in aggregate output, and the convertibility dynamic fostered a strong preference for maintaining it in this sector. Privatizations in public services and the banking system generated foreign investment and contributed to expanding the participation of the nontradable sector in the

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economy, creating a new pole of transnational business power.[4] Two subsectors whose dynamism was particularly intense after the rules changes and incentives were the companies of privatized public services and private banks.

At least three features shaped the preferences and resources of the public services companies. The dollarization of tariffs and its link to U.S. inflation affected the temporary consistency of convertibility—because of the distortion of relative prices—and created a strong preference in this sector for maintaining the currency board: both their financial positions (assets in pesos and debts in dollars) (Woodruff, 2005) and the potential incongruence of the regulatory framework under a floating regime (Gerchunoff, Bondorevsky, and Greco, 2003) made them resist devaluation. Second, the concentration of property among a handful of companies—with the exception of the electricity-generating sector (Murillo and Finchelstein, 2004)—contributed to conferring decisive market power on a very few players and, as a result, increasing their ability to influence state regulation (Azpiazu, 2003). This weakness in state regulation (Oszlak and Felder, 1998) increased the veto power of the companies over the entry of new players, thus managing to postpone the start of competition (see Murillo, 2009). Lastly, the guarantee of profitability provided by the regulatory framework to the privatized companies was sufficient to compensate for the effects of the recession after 1999, affording them considerable capacity for resistance during the last and worst years of convertibility. While the decline in activity negatively affected the balances of many tradable-goods companies, several public services companies maintained and expanded their profitability.

The preferences of the banking sector during the 1990s were affected by two processes: (1) the reduction and transfer to foreign hands of the banking system, which contributed to standardizing preferences and increasing the cohesion of the sector, and (2) the dollarization of the assets and liabilities of the financial system, which created a strong preference for avoiding devaluation.

1. Privatization, foreign ownership of banks, and the reduction of the sector's players affected the size and characteristics of financial system actors and their preferences and the composition of their institutional representation before the authorities.[5] Financial reform paved the way for the privatization process and bank liquidations, which accelerated with the Tequila effect in 1995. At the beginning of convertibility, the combination of economic stabilization and financial reform[6] led to an increase in the monetization of the system and allowed the banks better conditions for access to external lines of credit. These transformations promoted a wave of mergers and acquisitions—the number of financial entities dropped from 168 to 89 by 2000—and a robust increase in the assets and liabilities of the financial system (Alston and Gallo, 2000).[7] Government incentives for the privatization of provincial banks through the creation of the Trust Fund for Provincial Development also had an effect: these banks were reduced from 35 to 20 between 1991 and 1996. After the crisis unleashed by the Tequila effect, a good number of the large private domestic banks were sold to foreign banks. Through this, foreign banks tripled their share of total banking deposits, from 17 percent in 1994 to 44 percent in 1999. The number of branches grew significantly, from 391 in 1994 to 1,863 in 2000, and the financial system increased its concentration (Bleger, 2000; Levy Yeytati, de la Torre, and Schmukler, 2003). The government's preference for divesting

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itself of state banks rather than shouldering the costs of rescuing them led to unfavorable competition for public banks with respect to private financial entities and, in particular, to the branches of foreign banks, which used their origin and international image as a strategy for attracting clients. In sum, concentration of the banking structure and the dominance of private banks, especially local branches of foreign banks (reflected in the formation of the Association of Argentine Banks) allowed for a standardization of preferences dominated by actors that were born under convertibility and better organization for political action by the sector, allowing it to operate like a cartel.

2. The dollarization of the financial system's assets and liabilities contributed to the development of strong resistance to devaluation. The way in which dollarization affected preferences by the banks is consistent with the theory of financial intermediation (Hall, 2005): under a fixed exchange regime, as funding provided by the banking system grows in relation to other forms of funding, so does the propensity of banks to resist an abandonment of the peg. Faced with the emergence of imbalances, the banks' strategy was to bet on the efficacy of the prudential standards and the confidence that foreign interests would inspire, in the hope that time would reverse the uncertainty (as it did in the 1995 Tequila effect). But as the 2001 imbalances worsened banks had to assume immeasurably greater risks—refinancing debts in dollars for companies in arrears—in order to postpone until the last possible moment a stampede of bankruptcies that would drag the banking system down with it. If the fixed exchange rate continued, those risks were perceived to be far less than the foreseeable costs of a devaluation—insolvency of debtors—and the uncertainty stemming from the future configuration of business under a floating rate. And if they refused to refinance debts for the private sector, they most likely would have contributed to a stampede. Nevertheless, distrust intensified, and the run on deposits led the banks—in order to avoid their own failure—to demand the creation of temporary limits on withdrawals of deposits, which the monetary authority ultimately ordered on December 1, 2001.[8]

The way the Duhalde administration planned the exit from convertibility in January 2002—a floating rate and asymmetrical pesification—left the privatized public service companies and the banks on the defensive and in a worse position to influence the economic and political process. For the public service companies, maintaining dollarization of rates was hardly compatible with a floating exchange rate and even less so with the predictable tendency toward inflation that would be activated by devaluation. Likewise, the disincentives to investment arising from the de-dollarization of contracts—in contrast to the dynamism that devaluation bestowed on the tradable-goods sector—reduced the relative weight of service companies in the gross domestic product (GDP). The banks, for their part, relied on the authorities to resist the run on deposits and to bridge the gap produced by asymmetrical pesification. With pesification and the recovery of monetary policy the government became better able to help the financial system and granted privileges to public banks—in particular the Banco de la Provincia de Buenos Aires and the Banco Nación—over private ones, especially those with foreign capital.[9] With the majority of the property of banks and privatized companies in the hands of foreign enterprises belonging to the G-7, they faced a war of attrition through the IMF's pressure on the government to distribute the burden of the crisis.

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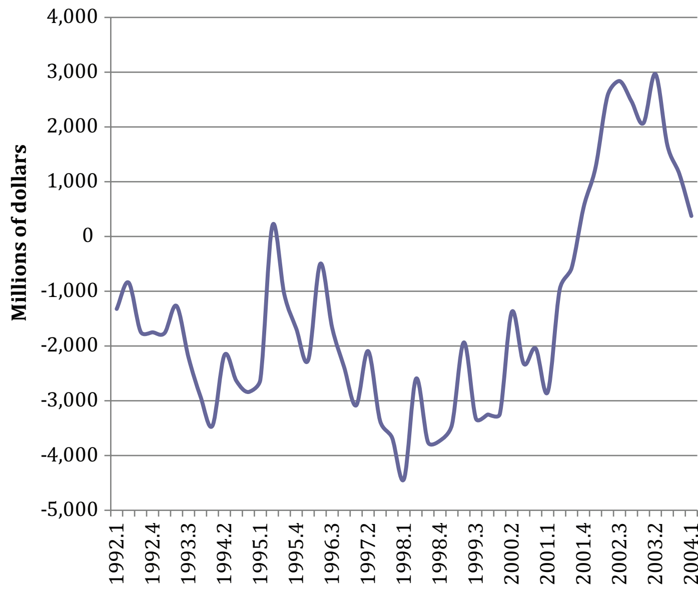

Figure 3. Current-account balance, 1992–2004 (data from the Ministry of the Economy).

THE PREFERENCES AND POWER OF INVESTORS

Under the convertibility regime, investors steadily increased their power to pressure the government, and their preferred exchange policy was to maintain the peg. Economic policy under convertibility led to an increase in the government's need to attract outside capital flows because of the tendency toward a trade deficit, pension fund reform, and rigidity in federal spending and coincided with the inclination of financial brokers to regard the state and the private sector as objects of credit business. The negative current-account performance (Figure 3) and the increase in fiscal needs reduced government's autonomy: maintaining the consistency of convertibility depended on the inflow of foreign currency to finance the trade and fiscal deficits.[10] The lack of a local capital market to attend public and private demand and the possibility of access to relatively low rates in dollars led the government to issue the majority of the debt under foreign laws (M. A. Kiguel, interview, November 22, 2007), and, as a result, the ability to repay required maintaining parity with the dollar.

The financial dynamic changed in the second half of the nineties with the entry of institutional funds and later of hedge funds (Daniel Marx, interview, January 2008).[11] Institutional investors—pension funds and international insurance companies—took advantage of Argentine debt instruments to increase the profitability of their investments. Mutual funds, extracting their profitability from performance, preferred to distribute risk by lending at very high rates and for very short terms (Maxfield, 1998).[12] In contrast, hedge funds took advantage of junctures of great uncertainty in which they perceived the fundamentals of the Argentine economy to remain solid (1997–2000) as business opportunities to buy national public bonds at low prices. But when they perceived a weakening of the fundamentals (from the last quarter of 2000) they set off sales in droves. In sum, the sensitivity of movements of the short-term rates of mutual funds

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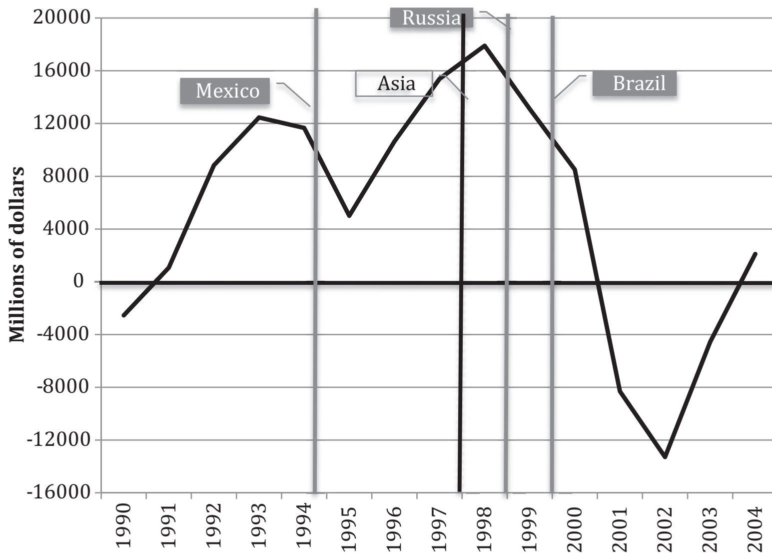

Figure 4. Movements of capital, 1990–2004, in relation to crises of 1994, 1997, 1998, and 1999 (data from the Ministry of the Economy and the Buenos Aires office of the Economic Commission for Latin America and the Caribbean).

promoted pro-cyclical courses of action, and the performance of hedge funds—buying cheap to sell when the price rises—contributed to restraining stampedes until the second quarter of 2000 and to encouraging them from then on.

The process of public bonds placement through large international investment banks[13] gave them advance knowledge about the government's tendency toward debt and about the preferences of claimants of government bonds. Many of these institutions became the voice of the voluntary markets through their reports from current analysis and risk index departments. Thus they created a dynamic of opposing interests: extracting profitability from the business and at the same time producing indicators of confidence in the investments they tendered (Blustein, 2005).[14]

A third group of actors predisposed to finance the Argentine government consisted of Italian, German, and Japanese banks, which toward the end of the 1990s offered their clients Argentine public bonds with much higher yields than they could obtain from their own countries' government securities.[15] And lastly, the government found emergency funding sources in retirement and pension fund administrators and market-makers' banks when faced with the closure of the international markets in 2000 and 2001. The Mexican (1994), Russian (1998), and Brazilian (1999) devaluations increased investor uncertainty about the sustainability of convertibility and the repayment capacity of the Argentine public bonds, triggering sudden stops of financial flows (Figure 4) and an increase in the cost of funding (Calvo, Izquierdo, and Talvi, 2003). The need to recover liquidity brought on a sale of the riskiest assets and a flight toward safer investment.

The increase in dollarization of the financial system ordered by the Banco Central de la República Argentina (BCRA), the government's inclination to close the fiscal deficit by raising the sales tax and lowering salaries two months before the 1995 presidential elections and the IMF agreement allowed for overcoming the uncertainty unleashed by the 1994–1995 Mexican crisis (Ganapolsky

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and Schmukler, 2001). For investors, the IMF intervention represented the safety of their investments: it supplied the funds to avoid systemic crises and at the same time induced the government to make adjustments in order to maintain the consistency of convertibility.

The Asian crisis in October 1997 did not lessen the propensity of investors to finance the fiscal and external imbalances of the Argentine economy. The measures for reducing financial system risk and transferring it to foreign hands (Beattie, 2000) and the economic recovery sustained the confidence of financial agents. However, post-Tequila growth did not manage to compensate for the negative impact on the fiscal requirements for pension fund reform and caused a great increase in the current-account deficit. Thus the consistency of convertibility and the debt was ever more dependent on the ability of the government to maintain the confidence of investors—in other words, to show that it wanted to and could maintain the fixed exchange rate and that under that regime it would be able to meet the maturities of interest and capital. This means that as the convertibility plan became barely sustainable on the fiscal and trade fronts in 1999, the weight of the preferences of foreign investors increased decisively.

For portfolio investors, the increase in uncertainty signified an opportunity as well as an increase in risk: they sold financing at a higher price and at the same time contributed to worsening the debt/GDP ratio, an exceptional indicator for measuring repayment capacity and future prices. Although investors affirmed their willingness to provide funds to the government well into the recession at the end of 2000, the financial and real deterioration of the Argentine economy triggered by the crises in Russia and Brazil produced an increase in the cost of financing (Figure 5).[16] Once the threshold was crossed where the price of funding interrupted the loan channels, the investors tried to protect their capital by pressuring the IMF to function as a lender of last resort (Claudio Loser, interview, December 18, 2007). Starting in 2001 the IMF injected liquidity so that the Argentine government could meet its debt obligations while access to credit remained closed.

THE PREFERENCE OF THE IMF

The evolution of the IMF's performance in this period can be divided into four phases:

Phase 1 (1991–1995). The exchange rate policy preference of the technical staff of the IMF for countries with external exposure and the historical rigidity of wages in Argentina inclined it toward flexible regimes (Cavallo and Cottani, 1997). Nevertheless, the stabilizing and disciplining effectiveness of convertibility, the academic climate regarding exchange regimes (which encouraged plans at the extremes, either free-floating or firmly fixed), and the privatizations carried out by the Argentine government converted resistance and skepticism into expectant support during the early years and more decidedly after the Tequila effect (Claudio Loser, interview, December 18, 2007; OEI-FMI, 2004). The limits of the currency board led the IMF conditionality to favor maintaining the fiscal and external consistency of convertibility: fiscal policy and the sustainability of the balance of payments were at the core of IMF-government relations between 1991 and 2001 (Allen, 2003).

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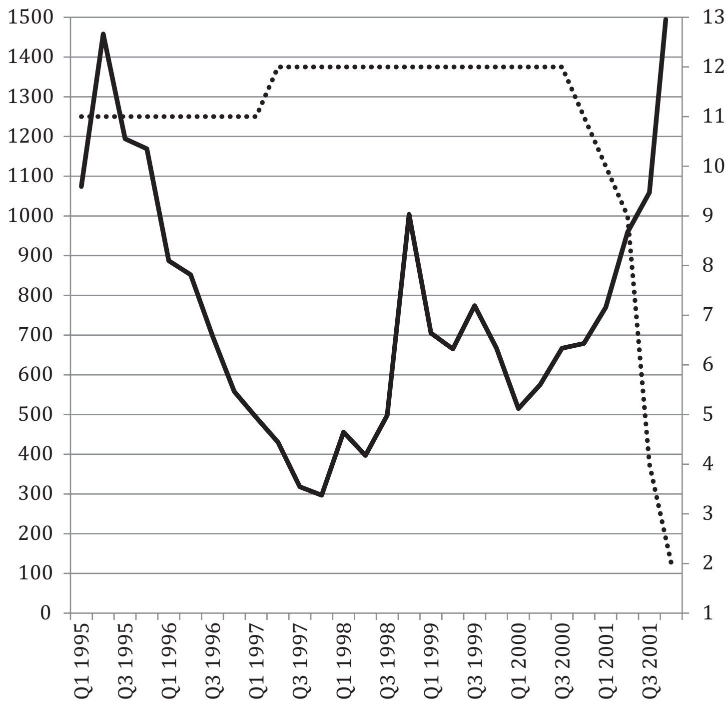

Figure 5. Country risk (solid line) and debt rating (dotted line), 1995–2002 (data from OECD Development Center, based on J. P. Morgan Global EMBI and Standard and Poor rating index).

The IMF staff concerns during the first phase were centered on the sustainability of revenues financed with indebtedness and pension fund reform (Claudio Loser, interview, December 18, 2007). The run on international reserves in 1994 placed the survival of the exchange rate regime in danger. The IMF conditioned financial support for sustaining convertibility (US$8 billion) on a series of fiscal adjustment measures: raising the sales tax by three points and cutting public wages in the middle of an electoral campaign. These governmental decisions led to a rapid return of financial market confidence (Ganapolsky and Schmukler, 2001), but their recessive effects increased the cost of GDP loss.

Phase 2 (1996–1999). Argentina's political and economic performance after the collapse of the Mexican peso strengthened the belief within the IMF that keeping convertibility was desirable,[17] and therefore, from 1996 to the end of 1998, the currency board received its strong support (IMF, 1998).[18] The rapid increase in exports reduced the significance of problems of competitiveness in the IMF's technical reports (OEI-FMI, 2004). Growth, shoring up the banking system, structural reforms, and the fact that the Argentine government did not request disbursements increased the tendency of the IMF management to forgive the slippage in the annual deficit goals, systematically unfulfilled as of 1994 (Mussa, 2002; M. A. Kiguel, interview, November 22, 2007). The resilience of the Argentine economy in confronting the Asian crisis confirmed the optimism of the IMF, which persisted after the Russian crisis and began to weaken

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only after the impact of the Brazilian devaluation on banking and the trade balance. This weakening was combined with a steady relaxation of conditionality: the IMF insisted on reform of the labor market and federal co-participation but without an official structural conditionality in the context of a program (Allen, 2003).

Phase 3 (1999–2001). As of the second semester of 1999, the IMF began to perceive that Argentina was dealing with a problem of macroeconomic fiscal and trade inconsistency and that this problem could lead to a crisis, but it refused to expand the financial assistance requested by the new authorities as the year ended. Thus it forced the de la Rúa administration to make a contractionary adjustment at the beginning of its term.[19] The drop in production and the rise of the cost of financing during 2000 were cause for an IMF technical report in October that evaluated alternatives to convertibility but did not find an alternative preferable to the currency board (OEI-FMI, 2004).[20]

In December 2000 the crisis deepened: the peso was overvalued, the deficit in the balance of payments was enormous, the government's fiscal revenues were falling as a result of the recession, and, because of the lack of confidence in repayment ability, the cost of financing rose. The assessment of the IMF technical staff coincided with the evaluation made by the Argentine government: that the risks in changing the fixed exchange rate were greater than the costs of maintaining it, that there was a reasonable likelihood that the problem was liquidity rather than solvency, and that any problem of sustainability of the currency board or the debt was manageable if strong measures were taken on the fiscal and structural fronts. In addition, the IMF, after the Asian crisis, made a change in the adjustment prescription in the face of economic imbalances: now the intervention it sought was to control the volatility of production activity and adjust the course of fiscal policy to the cycle (Claudio Loser, interview, December 18, 2007). Therefore the governing board approved a crisis assistance package that assumed resources from various sources of US$40 billion.[21] Despite this, the IMF established demanding quarterly fiscal goals whose nonfulfillment just two months after the launch of the package caused the resignation of Machinea, an increase in the country's risk, exacerbation of the decline of international reserves, and the beginning of a run on deposits.

In contrast to the efforts of Fernández and Machinea, those of Cavallo reduced cooperation between the IMF and the government. The IMF stopped being a reference source in decision making and disagreed with most of the measures taken by Cavallo—except for an increase in the tax burden and spending cuts[22]—but nevertheless expanded outlays and approved revisions until the end of 2001 (Claudio Loser, interview, December 18, 2007). It objected to the April 2001 decisions that foreshadowed a change in the status of convertibility (the upcoming introduction of a currency basket including the euro) and the competitiveness plans because they extended market uncertainty about a future devaluation without having its benefits (Claudio Loser, interview, December 18, 2007). But, using as justification the internal consensus of government initiatives adopted by legislation, the danger to the region's stability of Argentina's collapse, and the absence of less costly exit strategies, the IMF maintained its financing program (OEI-FMI, 2004).

The change in IMF management in early 2001 largely reflected a change in the intellectual trends and policies prevailing in the new U.S. administration,

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which favored the reduction of internal costs (through devaluation) and a restructuring of the debt that made the private sector a co-participant in the losses (Sturzenegger, 2003). Beginning in June 2001, in light of the loss of international reserves and while the Argentine government unilaterally advanced a voluntary mega-exchange of debt, the IMF began to suggest to the local authorities in official meetings a reconsideration of the currency board, although its technical staff never went so far as to propose a program for abandoning convertibility (Claudio Loser, interview, December 18, 2007). The costs of exiting, the absence of a strategy, and the fiscal cuts applied by the government forced the expansion of a special funding for immediate disbursement of US$5 billion in September designated for backing the reserves and US$3 billion to be applied in a future restructuring of the debt on the condition—not publicized—that the government agree to set a minimum threshold of reserves below which it would have to reconsider the maintenance of convertibility.

In the government's race to avoid a collapse of convertibility, retaining support from the IMF did not manage to avoid the continual deterioration of all the indicators, but it was decisive in keeping convertibility in force until December 2001. In early November, in response to the government's launch of an "orderly"—as opposed to "voluntary"—restructuring of the debt that distinguished national from international creditors, the IMF technical staff presented the managers with an alternative strategy consisting of more fiscal adjustment, restructuring of the debt, dollarization, and the disbursement of US$9 billion (OEI-FMI, 2004).

The fear that forced restructuring would affect local bank balances and discriminate against foreign creditors led to a new bank run (Blustein, 2005) in which deposits dropped more than US$3.6 billion in three days, accruing a reduction of 20 percent since the start of 2001. To avoid a failure of the banks the government ordered restrictions on withdrawal of deposits and affirmed that it would maintain convertibility. The IMF judged that convertibility could continue but only at a new par value that contemplated a depreciation. According to its technicians, restrictions on withdrawal of deposits indicated the opposite: the loss of ability to make transactions in a unified market meant exiting from convertibility, but the government insisted on maintaining the par value (Claudio Loser, interview, December 18, 2007). The imposition of the so-called *corralito* on deposits sparked the end of the IMF's support for the government's program and triggered the resignation of the minister and the president within days. If any hope remained for maintaining the value of the currency that had been in force for 10 years, it resided in the resources that the IMF could contribute to back it while the debt was restructured. The interruption of financial support for the program dashed those hopes.

*Phase 4 (2002–2003).*The design of the measures taken by the Duhalde administration in early 2002 (suspension of debt payments, controlled floating, reprogramming of deposits, asymmetrical pesification, and freezing of public service tariffs) reduced the IMF's inclination to collaborate, but the impact of these measures on the economy steadily reduced the IMF's power to exert pressure on the government's decisions. Reluctance to cooperate was based more on political differences than on technical disagreements. There were at least two sources of political distancing. The first stemmed from the lack of credibility of the Argentine decision makers: the U.S. Treasury secretary, John Taylor, and

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the IMF's managing director, Horst Köhler, and first deputy, Anne Krueger, had assumed their posts in early 2001 and thus had not participated in the period of the IMF's identification with convertibility. Indeed, they were managers of the funds of the international community in the period in which the decisions of the Argentine government, not in consultation with the IMF, had not only gobbled up US$22 billion in one year but also led the country to economic and financial collapse. Thus they had good reason to maintain their preferences. To this we must add that the new Argentine president was quickly losing internal consensus, and therefore his stability was not assured. The second source of political distancing can be found in the pressures from the country directors who weighed heavily in IMF decisions, whose companies and creditors—mostly European and Japanese—felt that their interests had been harmed by the way in which the government had distributed the costs of the collapse and its handling of economic policy. The outcome of these political differences was a radical change in the way in which the IMF traditionally exercised supervision: from "Let's support with funds and then see the results" to "First show results and then we will support with funds" (Claudio Loser, interview, December 18, 2007).

At the same time, the IMF was losing the power to impose sanctions: the competitiveness gained with the devaluation stimulated activity—matching market power between tradables and nontradables—and allowed the government to balance its fiscal accounts. Thus excessive demands without a financial contribution and with less capacity to pressure made negotiation impossible, and an entire year went by (until January 2003) before the IMF—despite resistance from its staff and pressure from the majority of its board—supported the government's economic program without enthusiasm. Assuming representation of the demands of groups that saw their profitability damaged–privatized companies, bondholders, and bankers–produced a lack of differentiation in demands. The IMF questioned the fiscal cost of asymmetrical pesification but pressured the government to assume the fiscal impact of a compulsory bond on deposits to resolve the maladjustment of the financial system. For its part, the government made progress on some of the IMF's demands (unification of the exchange market, repeal of laws that the IMF saw as creating legal insecurity) and resisted the relaxation of controls on floating and the reform of the financial relationship between the nation and the provinces.

CONCLUSIONS

I have shown that the government's decision to make convertibility sustainable politically and economically and the very dynamic of this exchange/monetary regime altered the relative weight of the actors with the ability to influence economic policy. The combination of convertibility and privatization in public services and the banking sector led to behavior on the part of actors with influence on exchange-rate policy oriented toward maintaining the currency board. This preference was guided by the extremely high costs that an eventual devaluation of the currency would impose on private actors. I have shown, however, that while some sectors reaped the benefits of the macroeconomic plan instituted by convertibility, support from other sectors—the tradables—required

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specific compensation. The indebtedness in foreign currency of the tradable-goods managers and the trade-offs they were obtaining because of their historical influence over the government discouraged any preference for flexibilization of the exchange system throughout most of the decade. The privatizations introduced actors with strong economic dynamism into the nontradable sector: public service companies with rates in dollars and bankers with exposed portfolios, who had enormous incentives for upholding convertibility or even seeking a more rigid system (dollarization). Nevertheless, confronted with exchange-rate appreciation and the deepening of the recession, the producers of tradable goods began to invest their political resources in placing devaluation and compensation to the debtors on the political agenda.

The investors who financed government expenditures with debt in foreign currency identified devaluation of local currency with the suspension of payments of the foreign debt. And despite the fact that the multilateral organizations conditioned their support on the fiscal and external consistency of convertibility, the cost of changing the currency peg forced continued financing of the government strategy of sustaining convertibility until the inconsistencies at last crossed the threshold of what was sustainable.

In spite of the greater fiscal and external consistency that stabilization based on a floating rate provided, lack of confidence in Argentine decision makers from IMF managers and the influence exercised over the IMF board by the governments of the countries whose companies and citizens had been affected by the Argentine government's distribution of the costs of the devaluation discouraged their collaboration. However, suspension of public debt payments decisively reduced the sanctioning power of investors, and the floating rate altered the dynamism of the economy by gradually reducing dependency on investment by the financial sector and the privatized public services companies. The IMF's withdrawal of support for convertibility was key to definitively undermining its survival, but the effects of the change of the exchange-rate regime—making it more flexible—gradually diminished the IMF's capacity to influence economic policy decisions. Funding needs sharply dropped, and competitiveness began to generate fiscal revenues, with the result that, once the value of the currency was stabilized, collaboration with the IMF was no longer indispensable for governing economic policy.

NOTES

1. Pérez Companc, Techint, and SOCMA were favored by the rules for the concessions to electrical services and telecommunications (Etchemendy, 2001). This reinforcement of the asymmetry of economic resources within the sector gave rise to "offensive" and "defensive" business behavior during the 1990s (Kosacoff and Ramos, 2002).

2. The credit gap, compensation, rapid recovery of confidence, and renewed growth in late 1995 sufficed to neutralize potential challenges to convertibility by the tradable-goods sector, but many companies took advantage of the opportunity to sell their assets. Between 1994 and 1998 sales by national enterprises in the market dropped 50 percent to 30 percent and those of foreign companies increased slightly more than 40 percent to almost 70 percent (Kosacoff, 1999).

3. Etchemendy (2005) suggests that once the compensation had been spent the tendency toward appreciation of the currency left the industrial sector with relatively unfavorable prices.

4. Production in services grew at a 7 percent annual rate between 1990 and 1998 (Heymann, 2000).

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5. Representation through the Asociación de Bancos Argentinos in 2000 was 90 percent in the hands of foreign banks.

6. The BCRA created a prudential standard according to the prescriptions of the Basel Committee and eliminated entrance restrictions for foreign companies.

7. Foreign entities increased from 31 to 38 (Bleger, 2000).

8. According to the BCRA, interbank loans reached 85 percent in November 2001 and virtually disappeared in December.

9. For foreign banks, the BCRA demanded that the parent bank supply a sum equivalent to the rediscounting provided to maintain liquidity.

10. The significance of interest increased as debt reduction bonds matured and low rates from the 1992 Brady Plan expired and were replaced with bonds at market prices. The drop in pension fund income was the result of the partial privatization of retirement funds in 1994.

11. The bonds produced by the Brady agreement and the new debt instruments began to be sold in secondary markets, and therefore their price could vary, making it impossible for the government to track their bearers (M. A. Kiguel, interview, November 22, 2007).

12. This mind-set was very different from that of the big banks in the 1980s, which stopped lending when the rate crossed a threshold.

13. Among those who participated most during this period were Merrill Lynch, Goldman Sachs, Salomon Brothers, Citigroup, Chase, UBS, Deutsche Bank, Credit Suisse, and First Boston.

14. The reports, especially as of 1998, tended to hide the information that indicated an increase in the probability that the Argentine government would not be able to meet its debt (Blustein, 2005).

15. "That's what kept Argentina going," according to Tom White, emerging-markets bond manager for Metropolitan Life Insurance (Blustein, 2005).

16. By March 2001 investors were selling their financing at 10 points above the rate for U.S. bonds, an impossible price for the Argentine government to confirm.

17. In its March 1995 report, the IMF position was explicitly in favor of maintaining convertibility (OEI-FMI, 2004).

18. President Menem was an invited speaker at the annual joint assembly of the IMF and the World Bank held in October 1998 because, according to the IMF managing director, Michel Camdessus, "Argentina has a story to tell the world."

19. At the beginning of 2000 an increase in tax burden was imposed, and later there was a cut in public expenditures.

20. The report advised against a floating rate because of the considerable dollarization of the economy and the substantial likelihood of initial overshooting. It maintained that the advantages and costs of dollarization at a depreciated exchange rate could help to improve competitiveness and moderate the initial effects of the devaluation but that it was not certain whether it would be credible and therefore sustainable.

21. The IMF contributed close to US$14 billion (by September US$22 billion), and the rest came from the World Bank, the Inter-American Development Bank, and foreign governments and in part from preliminary refinancing agreements in the domestic private sector.

22. In April 2001 Cavallo created a tax on financial transactions that provided extremely effective collections, and in July of the same year he declared a 13 percent cut in expenditures (wages and retirement funds) for public administration.

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