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Asian Political and International Studies Association
APISA Secretariat, School of History, Politics and Strategic Studies,
National University of Malaysia (UKM), 43600 Bangi, Selangor, Malaysia.
Email: secretariat@apisanet.com | web: www.apisanet.com

DEVELOPMENT STRATEGIES AFTER THE WASHINGTON CONSENSUS: The Case of Argentina (2002-2006)

Dora Orlansky
Leonardo Grottola
Mora Kantor

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ABSTRACT

The "lost semi decade 1998-2003" in Latin America showed a very disappointing socioeconomic picture. At the same time, more people in the region experienced a kind of "fatigue of reforms" (Birsdall et al 2001). The middle class in Latin America has perceived structural reforms (liberalization, deregulation and privatization) as obstacles to economic and social progress and modernization and privatization has been associated with corruption.

Alternative approaches have been proposed; some of them complementary to the Washington Consensus point of view and others from critical ones. The new approaches include among others the so called "second generation" reforms, the "Washington Contentious", the ECLA´s perspective, and the Social Forum of Porto Alegre 2002.

The following discussion focuses on reforms introduced in Argentina, and the strategies adopted to implement them.

Introduction

After the hyperinflationary crisis of 1989, Argentina launched an unprecedented state reform process which radically transformed the role of the state in the economic development. These reforms categorically rejected the former "import substitution" development strategy. The new reform agenda was consistent with the prevailing main-stream ideas in economics – the so called "Conventional Wisdom" or "Orthodoxy" – supported by International Financial Institutions (IFIs), namely the IMF and the World Bank, and consisted of a bunch of policies popularly known as the "Washington Consensus" (Williamson 1993).

However, Argentina did not embrace "Washington Consensus" (WC) completely. Argentina was never able to pursue very robustly disciplined fiscal policies in 1990s. The exchange rate system adopted under Convertibility Law (peso pegged to the US dollar) was far from the explicitly recommended flexible exchange rate regimes (Williamson 1993).

However, despite the absence of fiscally disciplined policies, Argentina's reform process can be considered as an example of following the WC policies, not only because IFIs recognized it as such in 1998, but also because the core elements of the reform package, summed up in the trilogy *stabilize-privatize-liberalize* (Rodrik 2006), were drastically introduced.

Argentina in the 1990s: Performance of Development Indicators

The 2001 Argentine crisis and failure to achieve sustainable growth – even after a reform process, which supposedly had removed the barriers for growth introduced during the protectionist era of "import substitution" – cast a shadow of doubt about the plausibility of reforms. In fact, they failed to unleash the forces of development. The market-oriented reforms came under serious questioning after a major economic crisis in 2001 in a country formerly presented as an example of their success.

Stiglitz (2003: 8-10) and Rodrik (2004b: 1-2 and 2004c: 3) observe that Latin America market-oriented reforms have failed to generate growth, and are mostly linked with the increase in inequality and poverty. Under "import substitution" policy, growth was almost two times faster than under reforms. In this sense, there was convergence with developed countries, divergence starting circa 1980. The argument that sustains that reforms needed time to succeed is discussed by Stiglitz who claims that results were even worse in the second half of the 1990s, a fact that led the CEPAL to call the 1997-2002 period as the "semi-lost decade" (Rodrik 2004b: 1-2 and 2004c: 3, Stiglitz 2003: 8-10).

During the early period of reforms (1989 to1993), almost all "development" indicators[1] show an improvement. There was growth in GDP[2]. High unemployment, which persisted for over a decade, improved only slightly[3]. However the poverty level fell from 42.5% in 1990 to 16.1% in 1994. Income Distribution Gap (quotient between average income of superior and inferior deciles) and GINI Coefficient show a similar performance. In both cases there was an initial reduction of inequality between 1989 and 1992.

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[1] GDP Growth (source: INDEC and CEPAL), Unemployment Rate, Quantity of Population below the Poverty Line (Poverty), Income Distribution Gap (source: INDEC, Great Buenos Aires agglomerate) and GINI Coefficient (Source: Period 1989-2000: Gasparini, Marchionni, Escudero (2000: 12), Period: 2001-2005: SIEMPRO data, Great Buenos Aires agglomerate)

[2] From a 6.2 % fall in 1989, during the peak of the hyperinflationary crisis and grew 28% in 1990-1994.

[3] From 8.6% in 1990 to 6.9% in 1992.

The second period of reforms started in 1993 and ended in 2002. Initially upward growth was registered after the 1995 Tequila crisis. It was over by 1998, the last year of moderate growth (3.9%) before the 1999-2002 slump. The critical 1999-2002 stage saw a 20% GDP reduction. The period witnessed one of the most severe economic and political crisis in Argentine history, which included simultaneous currency devaluation and debt default by the state. Unemployment rose from 9.9% in 1993 to 21.5% in 2002 (after the crisis, U rate lowered from 21.5 % in 2001-2002 to 12.8 % in 2006[4]). Poverty rose steadily from 1994 (16.1 %) to 2001 (32.7%). In 2003, a record level of 51.7 % of the population was below the poverty line. Indicators of income distribution show a worsening of the situation. The Income Distribution Gap (Quotient between average income of top and bottom deciles) enlarged the gap to 38 in 2002. GINI Coefficient started to deteriorate in 1992, which was quite high in Argentine history (0.418), to 0.461 in 1995, reaching 0.480 during 2000-2002 and 0,523[5] in 2003 2nd semester. The Great Buenos Aires, GBA agglomerate illustrates the magnitude of the crisis and its devastating effects on a country historically known to have egalitarian income distribution. It shouldn't be forgotten that 1974 GINI Coefficient was 0.322, a figure equivalent to those of developed countries.

Argentina in the 1990's: "Reform-based" Development Strategy's Failure – Some Possible Explanations

Growth performance from reform to crisis was unstable and unsustained; a very early stage of high rates growth that led many to believe that Argentine economy had once and for all taken off was followed by a long-lasting recession that ended in the virtual collapse of the economy. Unemployment remained persistently high since 1993 and even during "good" GDP's evolution years. Poverty, although reduced to a third of its 1989's rate in 1994, started to increase, reaching above 20 %, even before recession. Income distribution became gradually more unequal since 1993. Growth during the 1990s was accompanied by a permanently high level of unemployment and was unable to reduce poverty, let alone reduce inequality.

[4] Data corresponding to 2006 2nd quarter.

[5] This figure corresponds to the Continuous EPH (INDEC) introduced by INDEC in 2003 after some changes in methodology.

According to Stiglitz (2003: 16-19), Latin America's early 1990s unsustained growth can be explained as: i) a period of "catch up", familiar to those countries recovering from recession[6]. Argentina experienced a 3 % GDP reduction during 1981-1990 and the economy deepened its recession in 1989 as a result of the hyperinflationary crisis; ii) stimulus derived from enormous (mostly short-run) capital entry, which financed a consumption boom (consumption repressed or postponed during hyperinflation), with the consequent impact of foreign indebtment not oriented to high-profitable investment. Big amounts of capital entry were partly due to the massive privatization process undertaken during reform era; iii) inadequate national accounting over-estimated growth led to a false image of success during the first years of reform. *Net National Product* (NNP, Stiglitz 2003) would have reflected in a more accurate manner the real situation than the usual GDP-based accounting system.

Initial improvement in poverty reduction and in income distribution indicators is attributable almost totally to the positive effects of the dramatic fall of inflation experienced as a result of the anchoring effect of Convertibility Law (1991). Nonetheless, once distortions by high inflation were removed, poverty and income distribution indicators started to worsen. Convertibility proved to be an efficient device in reducing inflation. It gained legitimacy among all social classes. Not only hyperinflation 1989 but also previous high inflation during the seventies and the eighties provide an explanation for such support. It is important to bear in mind the convertibility's high degree of legitimacy to understand the 2001 crisis.

"Institutions Matter" and "Good Governance" Discourse

Once the Washington Consensus agenda started to show some setbacks, failures or "side-effects" (in those cases still considered successful, like the Argentine one), IFIs started to amend the original reform set. The new agenda was not cleared of any policies but rather had added new items to its laundry list, which led Dani Rodrik to call it "Augmented Washington Consensus" (Rodrik 2004b). Common to these new items is their relevance to countries' institutional settings. The role of institutions, ignored by the

[6] After recessions, there is usually "a period of "catch-up" as lost opportunities are taken advantage of, as investments embodying advances in technology are put into place" (Stiglitz 2003:16).

Washington Consensus, which focused on getting the macroeconomic fundamentals right, and privatizing, deregulating and liberalizing, became increasingly important in “development” policy proposals; so much so that it turned into “conventional wisdom”, summed up in the phrase “institutions matter”, as Fukuyama in a recent book rightly pointed out (Fukuyama 2004: 41-42). Developing countries should get institutions right in order to achieve successful reforms.

Douglass North renewed the neo-classical theoretical framework by stressing the role of institutions in economics (North 1989). The Northian paradigm strongly influenced the IFIs’ institutionalist perspective. Institutions’ relevance for development was also emphasized by heterodox economists like Stiglitz – who was undoubtedly inspired by the 1997 Asian crisis (Stiglitz 1998a) – and Rodrik (Rodrik 1999). Another institutionalist-heterodox economist, Ha-Joon Chang, argued that “good governance” discourse was adopted by the “orthodox” and the IFIs to justify the failure of their policies (Chang 2005:2).

Chang's remarks lead us to introduce ourselves into the following section, in which we study the arguments of some of the main Washington Consensus’ critics from a heterodox-institutionalist point of view.

Washington Consensus and its Critics

Academic critics of the Washington Consensus have had a louder voice since the 1997 East Asian financial crisis, which exposed the drawbacks of the liberalization of capital markets. Their voice became even louder after the Argentine 2001-2002 collapse. Those dissatisfied with “the policies advanced by the Washington Consensus” would agree to consider that they “… are not complete, and…sometimes misguided” and that development goals should be “broadened …to include other goals such as sustainable development, egalitarian development and democratic development” (Stiglitz 1998a: 1). This paragraph on “the critics” will be largely based on the academic work of Ha-Joon Chang, Dani Rodrik and Joseph Stiglitz, perhaps today’s most insightful proponents of alternatives to Washington Consensus. Our aim will be to describe the main aspects of the “emerging consensus” among “the critics” in order to determine whether their perspective can contribute to the explanation of the Argentine case evolution, especially after the 2001 collapse.

Successful Countries Didn't Follow Washington Consensus' Prescriptions

The strongest case for those uncomfortable with Washington Consensus ideology is that most successful developing countries are far from being a prototype of adherence to the Consensus policies. The East Asian pattern (the "developmental" state, see Chang and Evans 2000 for an extensive use of the concept to explain the Korean case) had been the traditional example of successful heterodox policies. Stiglitz stresses that East Asian countries' development provides the strongest reasons to abandon the Washington Consensus, given the fact that the group of countries that managed to reach what was perhaps the most successful development in history didn't adhere to the policies then canonized in the Consensus (Stiglitz 1998a: 2)[7].

> That development strategy (*Washington Consensus*) stands in marked contrast to the successful strategies pursued in East Asia, where the *development state* took an active role. (Stiglitz 2004b:1).

The fact that China, Vietnam and India are among the most successful growth performers gathers more evidence in favor of heterodoxy. As Dani Rodrik points out: "these high-growth countries have marched to their own drummers, and the fit between their policies and the conventional policy agenda is awkward at best. China and Vietnam are of course the chief exhibits here.… And India, despite the folk wisdom that relates its growth acceleration to the liberalization of 1991, actually began its take off a decade earlier, during the early 1980s and under heavy protectionism." (Rodrik 2004b: 2).

One Size Doesn't Fit All Specificity of Institutions

Institutional diversity's importance is strongly emphasized by the heterodox literature: highest growing developing countries have followed "deviated" policies and created institutional frameworks suited to local conditions.

The experience of China, a country which managed to promote investment without ensuring private property rights, has been highly influential for those who hold critical views towards the Washington Consensus. By contrast, the Russian reform process,

[7] In fact the East Asian performance was so outstanding that orthodoxy-leaning economists argued that its export-led growth model was an example of market and trade liberalization success.

which included massive privatization and the guaranteeing of Western-style private property rights, ended in a major crisis.

The motto goes as follows: the same function (we'd rather say "goal" or "objective" to avoid a misleading "functionalist" reading) can be achieved through different institutional forms in each society (or in the same society at different times) (Chang 2005: 4 and Rodrik 2006:11). According to the critics, Washington Consensus (its augmented version, too), denies institutional diversity and consist of a "laundry-list" (an item by item enumeration) that denies institutional diversity under the assumption that the same policy agenda can work in all contexts (Rodrik 2004b: 4). The importance assigned to specificity leads these authors to examine the relationship between institutions prevailing in developed and developing countries. Since "good" institutions are "quite idiosyncratic and context-specific" (Rodrik 2004a: 6), adopting developed countries' institutions without adapting them to local conditions may not promote but hinder development ("the institutional repertoire available in the advanced countries may be inappropriate to the needs of the society in question", Rodrik 1999: 14). International power relationships assert that (so-called) "best practice" institutions (a set of institutions significantly biased to include Anglo-American ones) should be imposed on *a priori* unwilling developing countries through "governance-related conditionalities" (Chang 2005: 3 and 6). Further elaboration on this point leads to consideration of the "good governance" discourse as a way of preserving the asymmetric *status quo* between developed and developing countries (Chang 2001: 28), which means maintaining an unfair global governance structure.

Current Global Governance Structure is Unfair

Global governance institutions have been subject to criticism as a result of their undemocratic rules and the fact that their actions usually tend to favor the interest of developed countries. Of course, procedural matters are related to the quality of the decisions that are made (Stiglitz 2004a: 1 and 9). In fact, "the decision-making structures are a far cry from principles that govern democratic decision making *within* countries." (Stiglitz 2004a: 8).

Global governance structure's unfairness becomes apparent when observing the rules governing the Bretton Woods institutions, international trade and intellectual property rights:

- *IFIs (International Financial Institutions)*: impose "global standard institutions" upon unwilling countries through "governance-related conditionalities" (Chang 2005: 6) and, due to the fact that votes are allocated on the basis of economic power (not even based on current economic standing) and a single country has veto power (at least in the case of the IMF), those countries exert very little influence not only on decisions that affect them but also on the election of decision-making authorities, which, as a result, become far from accountable (Stiglitz 2004a: 1 and 10).

- *International Trade Rules*: they restrict developing countries' access to markets as a result of the new protectionist mechanisms devised by developed countries (Stiglitz 1998b: 39). For an extensive analysis of the role of the *WTO (World Trade Organization)*, see Chang and Evans (2000).

- *(IPRs) Intellectual property rights*: its excessive international protection restricts knowledge transmission from the developed to developing world. (Stiglitz 1998b: 40)

Augmented Versions Are Ex-post Justifications of Washington Consensus' Failure

Critics of Washington Consensus' original version also disapprove of the Augmented one. They focus on the following weaknesses of the "augmenting" strategy: "developed countries in earlier times where institutionally *less* advanced compared to today's developing countries at similar stages of development", which means that "many institutions follow rather than lead, economic development" (Chang 2001: 1-2). Thus it would be tautological to argue that developing countries should be expected to establish institutions that they only can achieve by developing (Rodrik 2004b: 5). Enlarging the original list provides the framework to argue that original policies were right but didn't work because there was something missing; this argument could be repeated after every failure just by adding a new ingredient to the list (Chang 2005: 2; Rodrik 2004b: 5 and Rodrik 2006: 13).

The Government Has an Important Role to Play

Washington Consensus policies were based on a rejection of the state's activist role and on the promotion of a minimalist, non-interventionist state. The premise was: governments are worse than markets, the smaller the state the better the state (Stiglitz 1998a: 25). Washington Consensus-inspired reform policies were market-biased. They were unable to keep the adequate balance between state and market and often disregarded the importance of improving the public sector, since they believed in the market's capacity to solve all basic problems of society ("market fundamentalism"). This belief also led them to ignore the role of the state in a sound economy and to support trickle-down theory in spite of its failure (Stiglitz 2003: 21 and 27).

Stiglitz criticizes the Washington Consensus' view on the basis of theoretical and empirical foundations. Market-failure theory provides the arguments for an economic justification of state intervention. Market failure happens when the market is unable to allocate resources efficiently *in Pareto's terms*. Six kinds of market failure have been identified: lack of competition, public goods, externalities, incomplete markets, imperfect information and unemployment. Even if market failures were amended through state intervention and a *Pareto-efficient* resource-allocation were achieved, it might be a very unequal one. So income redistribution is another task the state should undertake once the fact that market-led income distribution can lead to unequal outcomes has been acknowledged (Stiglitz 1992:74-85).

This alternative perspective regards the government (the state) as a catalyst and as a complement to markets (Stiglitz 1998a: 25). The "question should not be whether a particular activity should be carried on in the public or private sector, but how the two can best complement each other, acting as partners in the development effort." (Stiglitz, 1998b: 25). Government as a complement should both i) provide resources to the market which, if left to itself, tends to systematically underprovide in arenas such as human capital (public education, access to funding) and technology (investment in the production and adoption of new technology) (Stiglitz 1998a: 26-27); and ii) create an enabling environment for the private sector and fight poverty (Stiglitz, 1998b: 26).

The East Asian miracle is again the decisive event for Washington Consensus' critics when considering the issue of government intervention. East Asian countries showed that a successful development process, involving both poverty reduction and widespread improvements in living standards, could be achieved with the government playing a large role (Stiglitz, 1998b: 10).

It's Important to Focus on Country-Specific "Binding Constraints"

A development strategy that is to avoid the Washington Consensus' flaws should concentrate on identifying a country's "binding constraints", which prevent the economy from growing: "countries do not need an extensive set of institutional reforms in order to start growing. …The trick is to be able to identify the binding constraint on economic growth at the relevant moment in time." (Rodrik 2004a: 11) This "diagnostic approach" distinguishes two different stages: the first one in which growth is initiated (ignites, is stimulated) with minimal changes in the institutional framework and the second, subsequent one, in which the initial "growth acceleration" has to be sustained in order to follow a development path. In this second stage, high growth and institutional change feed on each other (Rodrik 2004a: 10). Only once country-specific "binding constraints" have been identified can a set of policies to overcome them be designed. If this set of policies works and manages to produce a "growth acceleration", then the process should be institutionalized in order to foster sustainability and self-reinforcing growth. Growth should be institutionalized but growth is simultaneously a pre-requisite for institutional change (Rodrik 2004c: 12 and Rodrik 2006: 17).

Argentina After the 2001-2002 Crisis

In the following analysis we have used *Growth Diagnostics*[8] approach (Haussman, Rodrik and Velasco 2005) to an explanation of the 2001 Argentine crisis. Our aim will be to make use of some conceptual developments provided by Rodrik's theoretical framework: i) "Binding constraints" as obstacles that should be removed from a country

[8] Haussman, Rodrik and Velasco (2005) "develop a framework for *growth diagnostics* - that is, a strategy for figuring out the policy priorities. The strategy is aimed at identifying the most binding constraints on economic activity…". Identifying the "most binding constraints" (what aspects of a country's institutional framework that causes low growth) allows designing *growth strategies* suitable to the country's situation (Haussman, Rodrik and Velasco 2005: pp. 1-2). The authors provide the examples of Brazil, El Salvador and Dominican Republic as case studies they examine from a *growth diagnostics* perspective. However, our Argentine case study is based on the (*post factum)* post-crisis institutional changes and not on a previous rational analysis.

to resume growth; and ii) the distinction between two stages, the first in which growth initiates without great institutional changes, and the second in which growth and institutional change feed each other letting major institutional transformation happen (Rodrik 2004a: 10-11; 2004c: 12 and 2006: 17).

The 2001-2002 crisis brought the abandonment of Convertibility Law and a subsequent currency devaluation that led to a peso quotation (in terms of US dollars) of a third of its value under Convertibility Law and the implementation of a new exchange rate regime that could be termed as an intervened floatation. Since the second quarter of 2002 the economic cycle reverted. The GDP has grown at an average annual rate of 9% from 2003 onwards, output not only reaching but also surpassing 1998's GDP (highest peak before recession) in 2005, only four years after the crisis (Table 1)[9]. This Argentine recovery poses following questions about the causes of this "growth acceleration"[10]: Is it just a period of "catch up"[11] or a natural consequence of favorable international context of high prices for Argentine commodities and low international interest rates? Or the removal of the "most binding constraint"?

The "catch up" factor cannot be dismissed as part of the explanation due to the magnitude of 2001 collapse. However, the fact that "output exceeds the pre-episode peak level of income" (Rodrik, Hausmann and Pritchett 2005: 2) (Table 1) rules out the hypothesis of mere recovery.

[9] Per capita output in 2005 was still slightly smaller than 1998's. However, it can be taken for granted that the 1998 figure will have been outdone at the end of 2006. Since the average of growth forecasts for 2006 included in the Survey on Market Expectations (R.E.M., acronym in Spanish, elaborated by the Argentine Central Bank, see www.bcra.gov.ar/indicadores/ie000100.asp) is 7.6%, it can be assumed that GDP growth in 2006 will be around that figure. If 2006 GDP growth were 7.6%, 2006 GDP per capita would get at 1993 prices to 8.416 Argentine Pesos (2.715 dollars).

[10] We make liberal use of this concept. Rodrik, Hausmann and Pritchett (2005) define it as an "increase in growth (per capita growth of 2 percentage points or more)" that "has to be sustained for at least eight years and the post-acceleration growth rate has to be at least 3.5 percent per year. In addition, to rule out cases of pure recovery, we require that post-acceleration output exceed the preepisode peak level of income." Since recovery started in 2002 and 2006 will be predictably another year of high growth, the process has nearly 5 years, not 8, as the authors require. The Argentine case accomplishes with the other two requisites for growth acceleration, so we consider it a proximate case. Argentina's post-crisis experience can be undoubtedly classified as an "episode of rapid growth" (Rodrik, Hausmann and Pritchett 2005).

[11] Idem note nº 6.

In order to examine the second proposition which emphasizes the influence of international context, a set of some of the most important commodities exported by Argentina has been selected to observe the evolution of its prices in the 1990s and during the post-crisis period (Figure 1). Data on the international interest rate performance in recent years (considering USA-FF Interest Rate as indicator) is in Table 2.

The data on commodities prices provides a positive correlation between the Argentine economic cycle and agricultural commodities prices during 1993-2005 (Figure 1). Crude oil prices behave differently, softly fluctuating in the 1990s (U$S 15-20 per barrel), reaching at their lowest in 1998 (U$S 13 per barrel) to an unprecedented price of U$S 53 per barrel in 2005. The fact that crude oil has increased its share among Argentine exports in recent years and benefits from increasingly exorbitant prices since 2002 is a new reality that qualifies as an exceptional contribution to today's growth. However, this is not the case for the other commodities studied that also enjoyed high prices during the early 1990s. If we were to accept that current growth acceleration is only due to favorable agricultural commodities, we should explain early 1990s growth the same way. Hence, if such a "determinist" point of view was adopted, Argentine GDP fluctuations would be exclusively caused by the variation in commodities prices without acknowledging the impact of other factors. Hence, commodities' price, which experienced a significant improvement since 2001, is influential but not determinant[12].

International interest rate (USA-Federal Funds Interest Rate) lowered in mid-2001. The reduction was more pronounced since September 2001 and led to a rate of only 1% from June 2003 to May 2004. Such a low international interest rate must have played a part in the initial spurt of expansion. Nevertheless, USA-FF (Federal Funds) Interest Rate resumed an upward tendency in June 2004. In fact, it's been 5,25 % from June to September 2006. In spite of that, Argentina kept growing. Consequently, international interest rate is not a determinant of this growth acceleration, either.

[12] Actually, growing external demand for commodities rather than international prices is what explains more accurately the favourable commercial position of Argentina. However, it's important to point out that such an unexpected performance has been possible only because of the technological innovations on the agricultural (private) sector during the 1990s.

Although the post–recession "catch up" process and the positive international context described above shouldn't be dismissed as reasons for today's growth, the country's institutional framework cannot be ignored. This leads us to the "diagnostic approach" and, consequently to the search of the "most binding constraint" impeding growth. Rodrik himself suggests the answer: "Argentina's currency board, which removed monetary policy from the hands of the government, worked well when the binding constraint was lack of credibility…" in a mere government's promise of not resorting to the inflationary tax "…but led to disastrous outcomes when the binding constraint became an overvalued currency." (Rodrik 2006: 7).

In order to analyze the hypothesis of an overvalued currency as a binding constraint our analysis will include the following variables: relative prices between services and goods (as an indicator for relative prices between non-tradable and tradable goods), real exchange rates (USA, Brazil, Eurozone), exports and imports and current account (Figures 2, 3 and 4). Data suggest that convertibility led to an overvalued real exchange rate (*vis a vis* some of Argentina's main trade partners we take into account: USA, Brazil, and Eurozone countries); a relative prices structure which privileged services over goods (non-tradable over tradable), certainly not the right incentive for an export-led growth strategy. Consequently, Argentina experienced a continuous rise in imports not matched by its exports, resulting into a trade imbalance and a permanent current account deficit.

The change of exchange rate regime that took place in 2002 transformed relative price structure to one that rewards goods over services, tradable over non-tradable, and implied a real exchange rate depreciation. The new situation encourages export-led growth and import substitution. In fact, trade balance and current account surplus were achieved and exports have risen 56% in 2002-2005. It can be observed (Table 3) that exports augmentation is a genuine one, not exclusively attributable to a rise in their prices but also to increase in quantities exported. Manufacturing industry's strong output growth since 2003 (Table 4) supports the assumption of new exchange rate regime's beneficial effects on industry.

The evolution of investment is another variable that should be taken into consideration to evaluate the sustainability of growth in Argentina (Table 5). Recession caused a

56.3% fall in investment between 1998-2002 and a rise in investment of 127.9% took place between 2002-2005. When measured as a percentage of GDP, investment suffered a dramatic drop during recession. The lowest level was 11.3% in 2002, to recover since then, reaching 19.8% in 2005, a figure slightly less than the pre-recession one of 21.1%.

Thus, correcting the relative prices distortion produced by exchange rate overvaluation resulting from convertibility's rigidity reveals itself as an important factor in igniting growth. The change in relative prices caused by devaluation seems to lift the barriers for growth, that peso overvaluation was imposing on the economy. According to this approach, overvalued currency could be considered Argentina's "binding constraint" for growth before 2002. Should the diagnostic framework been applied to economic policy making in the Argentine case, the advice would have been to engineer adequate devices to an orderly exit from convertibility. Argentine authorities' obstinate attempt of sticking to convertibility led to hard landing through market devaluation with hurting side-effects: generalized contract breaking and abrupt (and unequal) income re-distribution[13]. Since contracts were either in dollars or in pesos convertible to dollars at a 1 to 1 exchange rate, they had to be adapted to post-convertibility (since, at first, many didn't accept the restructuring decided by the government, lawsuits flourished). Contract restructuring caused income re-distribution, and inflation in 2002 (especially of food articles insofar tradable goods) brought about the unequal income re-distribution.

Rigidity and Legitimacy: The Role of Ideas

In addition to Rodrik´s statement on an overvalued currency as a "binding constraint" on Argentina, it is interesting to notice that Argentina was considered to be one of the most successful examples of a trend in the 1990´s which consisted in creating macroeconomic stability through legal changes, reducing the role of the state in monetary policy. Argentina's 2001 crisis and the subsequent abandonment of the convertibility regime illustrated the fact that rigid rules are no substitute for the government's discretion (World Bank 2005:8).

[13] Another feature not considered in this paper is Argentina's sovereign debt default and restructuring.

The 2001 crisis also raised the question on the prevailing pro market-oriented reforms. In this regard, it can be said that if the hyperinflationary crisis of 1989 brought up significant pro-structural reforms, the 2001 reforms stressed the weakening and loss of legitimacy of market-leaning reform policies. Actually, the developing countries lost enthusiasm for pro-market reforms because of their failure regarding its most important promise, i.e. sustained growth and development (Fanelli and Popov 2003). Disappointing results of the reform process caused what some authors have called "reform fatigue". Structural reforms, in particular the trilogy of liberalization, privatization and deregulation, were perceived as key issues in the deterioration of life standards (Birdsall and De la Torre 2001).

The Government's Role After the Crisis

In fact, state reform in the 1990s was part of the process of neoliberal globalization, which has basically been defined by four characteristics: 1) the decline of the economic power of state actors; 2) the growing penetration of market forces in new spheres of activity; 3) the remarkable increase in transnational circulation of capital, goods and services; and 4) the unprecedented dissemination of ideas supporting reform through networks of scientists, experts and/or distinguished professionals (*epistemic communities*) that exerted a significant influence on the government agenda setting and its international convergence (Haas 1992).

The following processes were hastily prompted: i) privatization of state companies, social insurance and social services; ii) outsourcing of many public sector activities; iii) deregulation of the economy – including labor relations – ; and, in general, iv) the abandonment to the role of the state as agent of development. More than 300.000 jobs were removed from the public sector payroll as a result of privatization and, although it is not easy to determine the reduction of public employment caused by outsourcing, it can be ascertained its progressive increase in the public budget..

However, in spite of the restrictive policies and the anti-state rhetoric of the 1990s, between 1991 and 2001, public employment experienced a 4.2% growth. Indeed, according to 1991 and 2001 Censuses, the volume of public employment rose from 2,221,348 to 2,313,793. Nevertheless, public employment reduced its share in the labor market; measured as a percentage of economically active population, it fell from 16.8% in 1991 to 15.2% in 2001.

Prior to the privatization of public enterprises in the first half of the 1990s, the labor market experienced the steady elimination of public sector jobs, and subsequently a much significant and relentless loss of jobs in the private sector. Therefore, those who had lost public jobs still formed both a smaller and decreasing proportion of the total number of unemployed wage-earners (1996: 6.4%; 2001: 4.9%; 2005: 3.7%), as well as a low and decreasing proportion of the public employment payroll (5.0%; 4.3%; 2.1%); this pattern contrasts with the level of unemployment among wage-earners in the private sector, where one out of five, and even out of four, was unemployed (21.4%; 26%; 19.5%).[14]

More recently, the labor market has displayed a different trend. Unemployment decreased and, although public employment increased, it did so at a low rate. As a result, if one were to compare 2005 to 2001, public employment carried less weight in the economically active population (2001:13.7%; 2005:13.2%) and noticeably less weight in terms of all employed wage-earners (2001: 23.5% y 2005: 19.9%).

Leading up to 2005, there was another turn from the 1990s. Public employment in all the areas subject to privatization reforms — namely, transportation, construction, communications, and the supply of electricity, gas, and water — experienced substantial growth. This is a very revealing finding: it discloses the new role played by the state in the economy, largely because the increase in public employment overall was very low, to the point that there was even a decrease in the typically state-run functions, i.e. *administration* and *defense*.

In summary, although the relative impact of public employment on the labor market did not increase (but rather decreased) leading up to 2005, its revival in various areas of activity suggests growing state intervention, as opposed to the state withdrawal experienced by the 1990s.

[14] Source: EPH-INDEC 1996, 2001 and 2005

Following is a brief discussion of public policy actions taken by the Argentine government in the post-crisis period. Examples of government's role and intervention after the crisis can be grouped in the following categories:

Re-statization: It involved a process of contract renegotiation with the companies in charge of public services supply. "Re-statization" only happened in those cases of concessionaires' most flagrant unfulfillment of their obligations. Irrespective of legal forms employed, reference to "re-statization" included all situations in which private concessionaires were replaced by new created state owned companies. Such as the postal service[15], a railway branch in Great Buenos Aires[16], the water and sewers supply service for Great Buenos Aires[17], and the state petroleum company Enarsa (in this case, the company didn't replace the private concessionaire, it co-exists with the privatized company Repsol-YPF and other companies that operate in the Argentine market) [18].

Price Agreements: **A**s one of its main instruments aimed at inflation control, the government's strategy included arrangements with business sector's representatives. Since the government considers prices shouldn't exceed business production costs plus a "fair and reasonable" profit, business representatives were asked to keep set prices for a period of time, established in arrangements. In general, arrangements are signed for a year. However, clauses can be modified every two months. At the time of writing, those arrangements about to expire were renewed for another year. This course of action implied a rejection of price determination through market procedures.

Temporary restrictions on beef exports: Due to consistent increases in beef prices government decided to restrict beef exports for 6 months in order to guarantee an adequate domestic market supply and consequently get a reduction in prices. After

[15] The state-managed Correo Oficial de la República Argentina S.A. was created by Decree 721/2004.

[16] Emergency service management was assigned to the Unit of Operative Management which is composed of the other metropolitan railway branches concessionaires and coordinated by the Secretary of Transport – Ministry of Federal Planning, Public Investment and Services, see decree 798/2004 and Secretary of Transport Resolution Nº 408/2004

[17] The company AySA S.A. was created. It is in change of the supply of water and sewers in the City of Buenos Aires and some of the suburban districts. See Decrees 303/2006 and 304/2006.

[18] See Law Nº 25.943. Available www.infoleg.gov.ar

negotiations and agreements with representatives of cattle business sector, the measure was relaxed, establishing a quotas system for beef exports. [19]

In conclusion, post-crisis government action has not implied a reversion of market-oriented reforms, so it shouldn't be considered a clearly stated, rationally and coherently devised, "new" development strategy. It could be more accurately described as a set of pragmatic *ad-hoc* interventions. It is not evident whether immediate post-crisis state action allows of plans, strategies or "get out of a jam" decisions imposed by circumstances.

State interventions studied here are a good example of the market failure theory (Stiglitz 1992:74-85) as well as the idea of government as complement to markets and the one able to remedy socially unsatisfactory or unacceptable outcomes produced by markets when left to themselves.

Summary

- Since second quarter of 2002 the economic cycle reverted, and the GDP has grown at an average annual rate of 9 % from 2003 onwards

- Unemployment rate decreased from 21.5% in 2002 to 12.7 % in 2005.

- Population below the poverty line has also experienced a reduction during this period. From 54,3 % in the second semester of 2002 to 31.4 % in the first semester of 2006.

- Besides the decrease in unemployment rate and poverty level, it is relevant to emphasize the existence of employed people below the poverty line. This fact is also illustrated by the loss of purchasing power suffered by employed people after the exchange rate devaluation. Following INDEC´s data, the average

[19] See Ministry of Economy Resolution Nº 114/2006 and Ministry of Economy Resolution Nº 397/2006.

monthly income perceived by employed people in 2005 was $839, 45.9% more than in 2001. However, prices increased 74.7% during the same period[20]

- Indicators measuring inequality almost do not show alteration during this period. There is a visible increase in the Income Distribution Gap in 2003 which is related to the effects of the 2001-2002 crisis. With regards to the GINI Coefficient, there are no significant differences either. Both values of the inequality indicators are still very high.

- It is still soon to answer if this "episode of rapid growth" Argentina is experiencing since the second quarter of 2002 will be able to lead to a sustained self-reinforcing path of economic growth and institutional change. In the near future we will be able to know if Rodrikean second stage of growth plus institutional change is about to come or this "growth acceleration" fizzles out.
- The post-crisis government action has not implied a reversion of market-oriented reforms introduced during the 1990s, therefore, it shouldn't be considered a clearly stated, rationally and coherently devised, "new" development strategy. It could be more accurately described as a set of pragmatic ad-hoc interventions.

This paper is based upon the materials of a research project, "State Reform Agendas and Development Strategies: Ideas, Policies, Outcomes", directed by Dora Orlansky and supported by a grant of the University of Buenos Aires (UBACYT SO62).

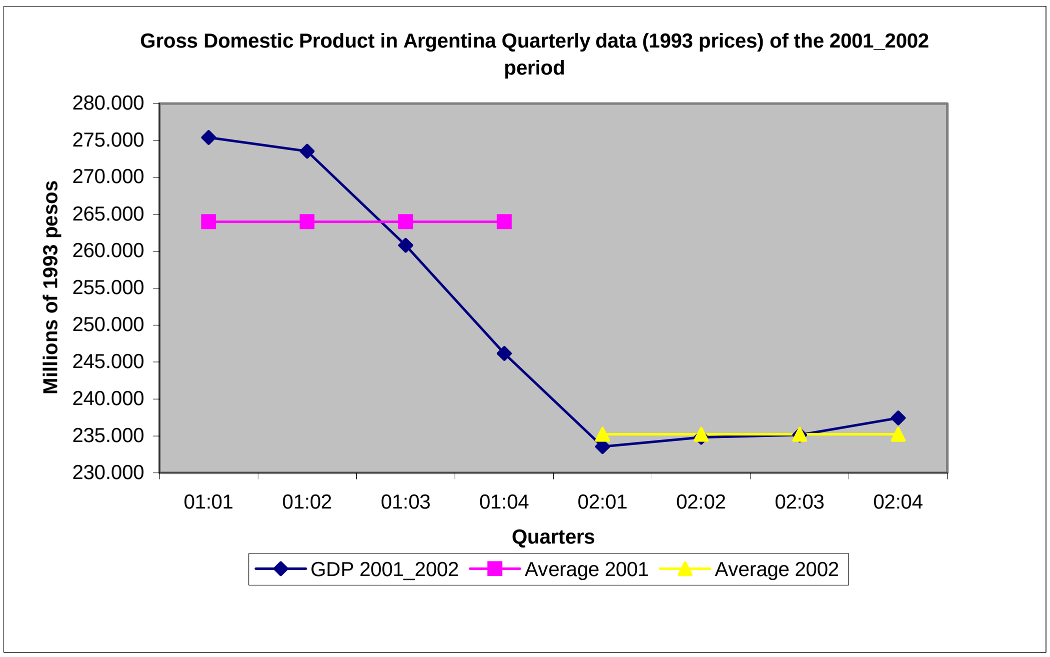
[20] Diario Clarín. 2006. La mitad de la gente que tiene empleo gana menos de $ 600 al mes. *(Half of the people that have a job earns less than 200 dollars monthly)* [22 April]. Available www.clarin.com/diario/2006/04/22/elpais/p-00801.htm

APENDICES

Table 1: Gross Domestic Product in Argentina – From Recession to Recovery

Year	1998	1999	2000	2001	2002(*)	2003(*)	2004(*)	2005(*)
GDP (thousand pesos)	**288.123.305**	278.369.014	276.172.685	263.996.674	235.235.597	256.023.462	279.141.289	**304.815.326**
GDP Annual Percentage Variation	3,9 %	-3,4 %	-0,8 %	-4,4 %	-10,9 %	8,8%	9%	9,2%
GDP per capita (1993 pesos) (**)	**8.000**	7.600	7.500	7.100	6.300	6.800	7.300	**7.900**

Source: INDEC, figures at 1993 prices (*) Provisional estimations (**) Calculated on the basis of INDEC's population estimations



GDP annual percentage variation statistics show a 10,9 % fall in 2002. It is the result of a comparison between average GDPs of the previous and following year (in this case, 2001 and 2002). So a 10,9 % descent in 2002 means that average 2002 GDP was 10,9 % smaller than 2001's. However, it doesn't mean the 10,9 % drop happened in 2002. When observing quarterly information for 2001-2002 it can be found that most of GDP's shrinking took place in 2001 (convertibility's last year) and that 2002 is in fact the first year of recovery (GDP started to grow in 2002's second quarter). In spite of recovery, average 2002 GDP kept well below 2001's, in part due to the magnitude of the previous year's decline, which explains the 10,9 % fall measured by statistics.

Source: Damill, M. (2003): "La reactivación cumple un año", *Clarín, Buenos Aires, Suplemento Económico*, 6 de abril de 2003 (translation by the authors)

Table 2: USA-FF (Federal Funds) Interest Rate 2000-2006 (monthly)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
2000	5,5	5,75	6	6	6,5	6,5	6,5	6,5	6,5	6,5	6,5	6,5
2001	5,5	5,5	5	4,5	4	3,75	3,75	3,5	3	2,5	2	1,75
2002	1,75	1,75	1,75	1,75	1,75	1,75	1,75	1,75	1,75	1,75	1,25	1,25
2003	1,25	1,25	1,25	1,25	1,25	1	1	1	1	1	1	1
2004	1	1	1	1	1	1,25	1,25	1,5	1,75	1,75	2	2,25
2005	2,25	2,5	2,75	2,75	3	3,25	3,25	3,5	3,75	3,75	4	4,25
2006	4,5	4,5	4,75	4,75								

Source: Economy Ministry on the basis of US Federal Reserve Data

Table 3: Indexes of value, prices and quantities of goods exports

Year	Indexes		
	Value	Price	Quantity
1998	201,6	100,3	201,0
1999	177,7	89,1	199,5
2000	200,8	98,0	204,9
2001	202,3	94,7	213,7
2002	196,0	91,0	215,3
2003	225,7	99,7	226,4
2004	263,4	109,1	241,3
2005	305,0	110,7	275,5

Source: INDEC Year base 1993=100 (*) Provisional figures

Table 4: Manufacturing industry output annual percentage variation

1994	1995	1996	1997	1998	1999	2000	2001	2002(*)	2003(*)	2004(*)	2005(*)
4,5%	-7,2%	6,5%	9,2%	1,8%	-7,9%	-3,8%	-7,4%	-11%	16%	12%	7,7%

Source: INDEC, based on figures at 1993 prices (*) Provisional estimations

Table 5: Investment in Argentina : 1994-2005

Year	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002(*)**	**2003(*)**	**2004(*)**	**2005(*)**
Investment Annual Percentage Variation	13,7%	-13,1%	8,9%	17,7%	6,5%	-12,6%	-6,8%	-15,7%	-36,4%	38,2%	34,4%	22,7%
Investment as a percentage of GDP	20,5%	18,3%	18,9%	20,6%	21,1%	19,1%	17,9%	15,8%	11,3%	14,3%	17,7%	19,8%

Source: INDEC, based figures at 1993 prices

(*) Provisional estimations

FIGURE 1

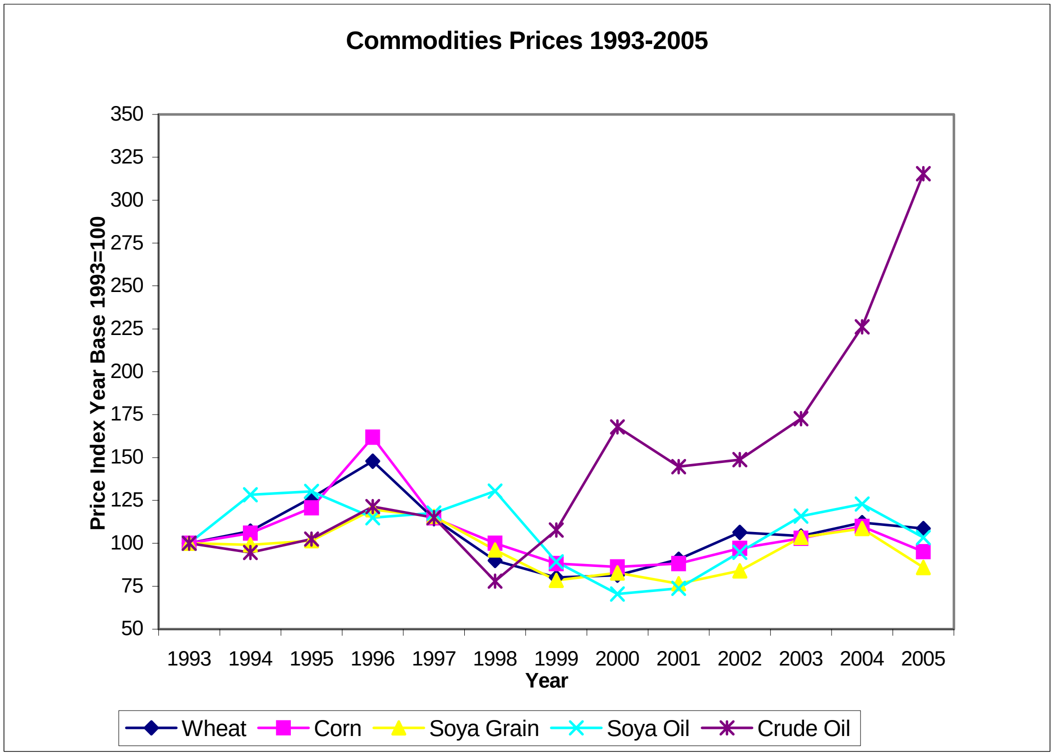
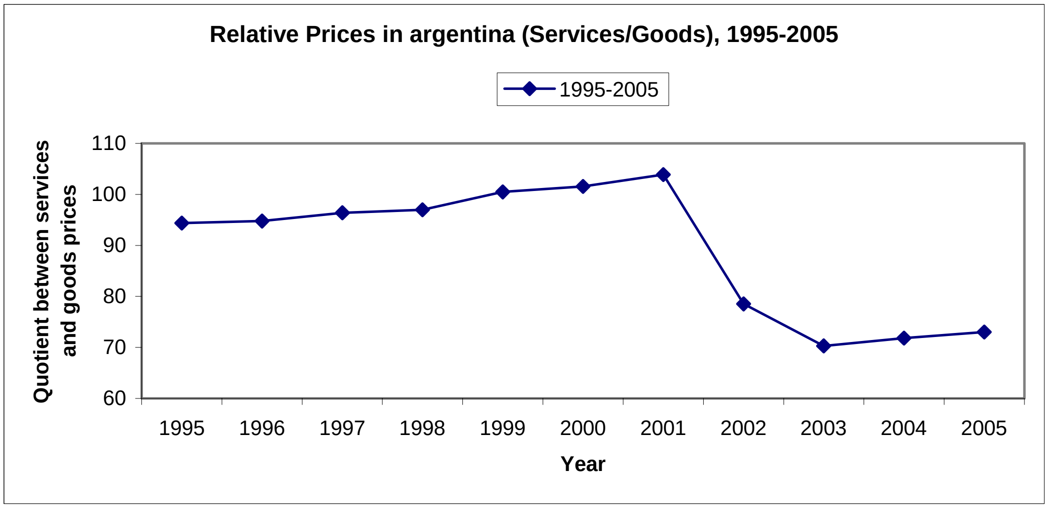


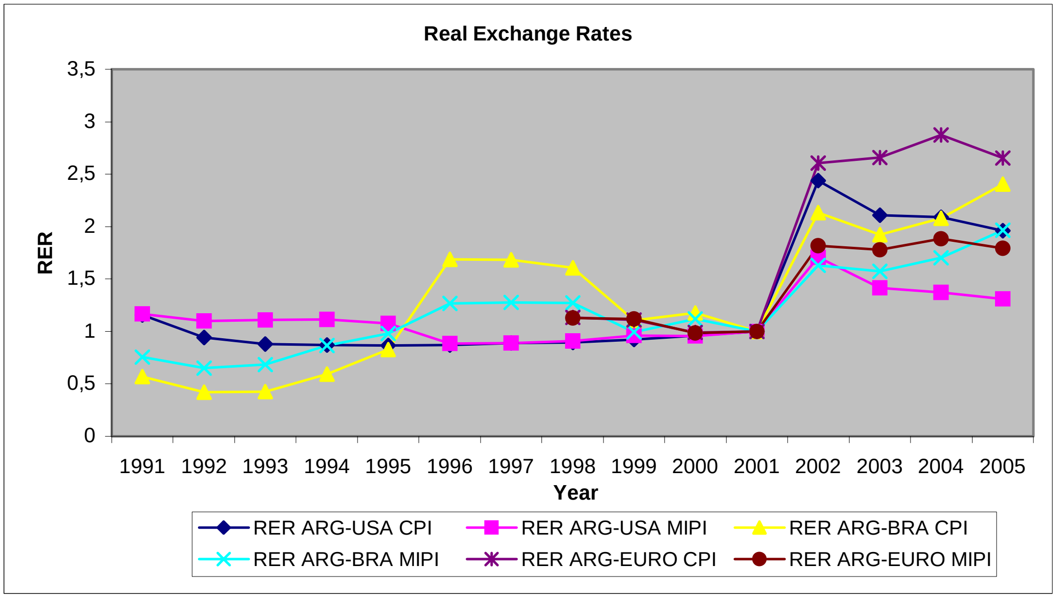
FIGURE 2



Source: Economic Policy Secretary (Economy Ministry) on the basis of INDEC data.

1999= 100 Year base

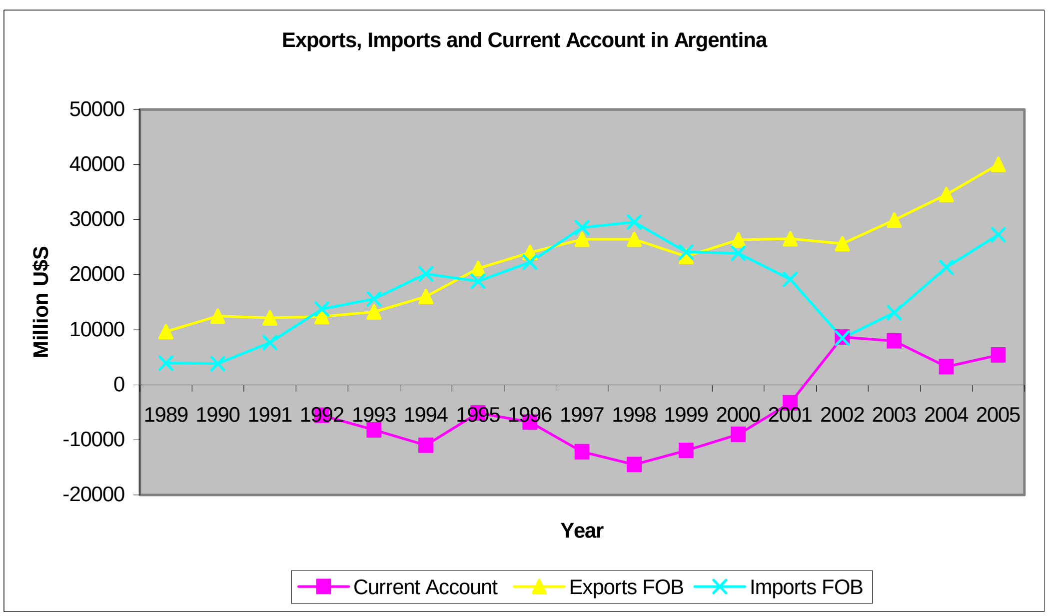
FIGURE 3



Source: Economic Policy Secretary (Economy Ministry) on the basis of INDEC, IMF and Bloomberg data.

CPI: Consumer Price Index MIPI: Manufacturing Industry Price Index

FIGURE 4



Source: INDEC

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Dora Orlansky is Full Professor at the Political Science Department (UBA) and Director of the Public Sector and State Reform Research Program at the Instituto de Investigaciones Gino Germani (IIGG/UBA; www.iigg.fsoc.uba.ar/sepure). **Leonardo Grottola** (Ph. D. UBA candidate) and **Mora Kantor** are graduate research associates at the IIGG/UBA. Send comments to orlansky@mail.retina.ar