

## Argentina's Lost Half-Decade 1997–2002

### *Introduction*

In the early 1990s, Argentina's economy was hailed as a new socio-economic model for Latin American nations. After overcoming hyperinflation and economic turmoil in previous decades, the economy of the early 1990s was nothing short of an economic miracle. The reasons behind the stellar performance of the Argentinian economy were well-documented: a fast-growing and well-educated workforce and a business-friendly policy environment. Between 1991 and 1997, President Carlos Menem carried out a series of neoliberal reforms that stabilized the economy, such as privatizing numerous industries, setting a fixed exchange rate to the US dollar, and encouraging foreign direct investment. These reforms resulted in low inflation, high productivity, and reduced unemployment. However, this approach was only a temporary fix and could not permanently alleviate Argentina's debt. Argentina experienced an economic decline during 1997–2002 that was so steep that the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC) named it as the *lost half-decade*. Living standards plummeted, and by the end of the millennium, most Argentines were as poor as, or poorer than, they had been for decades. Today, after over a decade of stagnation, Argentina's economy still suffers from recurring economic crises, persistent fiscal and current account deficits, high inflation, mounting external debt, and capital flight.

### *Currency Crisis (1997–1999)*

Crippled by interest payments on external debt, corruption, tax evasion, and capital flight, Argentina endured a period of hyperinflation and economic stagnation from 1975 to 1990. In an effort to relieve the economy, in 1991, finance minister Domingo Cavallo decided to peg the peso – Argentina's currency – to the US dollar. His goal was to stop hyperinflation and restore confidence in the Argentinian financial system.

Complementary measures such as trade liberalization, deregulation, and privatization helped Argentina to shift towards a competitive market economy. This strategy helped alleviate the deteriorating economy momentarily. Inflation decreased, and the Argentinian government gained full access to external finance. Meanwhile, Argentina's debt burden soared. The fixed exchange rate of pegging the peso to the US dollar did not allow for the correction of imbalances in the country's payments, because the currency could not appreciate/depreciate as dictated by the market; in other words, Argentina's currency value no longer correlated to economic performance.

Several external economic shocks caused the Argentinian economy to collapse in 1997–1999. The financial crisis that gripped Asia in July of 1997 raised fears of a worldwide economic meltdown and led to panicked investors pulling their capital out of the markets. Anxiety loomed over the global markets, and developing regions were the first to feel the effects. In 1998, Russia defaulted on its foreign debt. In January of 1999,

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a financial crisis caused by its inability to raise funds forced Brazil to devalue its currency, the real. Because Argentina had a fixed exchange rate to the US dollar, its exports became increasingly expensive and less desirable compared to those from other nations. Argentina's decrease in exports and reliance on imports disrupted the balance of trade, creating a large budget deficit.

### *Economic and Banking Crisis (1999–2001)*

Argentina was South America's second-largest economy after Brazil. In the last months of 1999, political and economic chaos continued to envelop Argentina. President Carlos Menem attempted to run for a third consecutive term, which was ruled unconstitutional. The elections held in December 1999 were marked by indecision and uncertainty. Corruption plagued the Peronist party – now represented by Eduardo Duhalde. The opposition was the Alliance party, a coalition formed in 1997 by the Radical Civic Union, the Front for a Country in Solidarity, and several other smaller regional parties. The Alliance – represented by Fernando de la Rúa – offered a moderate progressive alternative, but it had no electoral experience. De la Rúa was inaugurated on December 10, 1999; he had inherited a country plagued by economic decay. The country's foreign debt had reached \$132 billion dollars, which was over 50% of its GDP (Independent Evaluation Office 2004). With recession dragging on, in June 2000 unemployment reached 14% and interest rates soared (Wikipedia 2013). Economists world-wide continued to assert that Argentina would not be able to obtain the funds necessary to balance its budget.

Crippled by debt and mismanagement, the Argentinian government could no longer afford to maintain proper public services. Roads, railways, water, power, and telephone systems deteriorated; schools, universities, and hospitals lacked funding; scientific facilities and statistical offices became early casualties. At every level, the government's capabilities to function quickly diminished. A drastic erosion of civil service salaries wrecked what was left of the morale, honesty, and efficiency of civil servants. The failed economy impoverished large segments of the middle class and led to the flight of large sums of capital out of the country.

Unable to raise funds locally and shunned by commercial banks abroad, Argentina opted for rescue by the International Monetary Fund (IMF). In effect, Western donor institutions took over as Argentina's bankers. In December of 2000, the IMF approved a \$22 billion support program for Argentina, but the markets continued to slide and undermine the confidence in the government's ability to save Argentina's economy from defaulting (Independent Evaluation Office 2004). In August of 2001, the IMF loaned an extra \$8 billion to Argentina, under the condition that part of the money was to be used to pay its sovereign and foreign debt (Independent Evaluation Office 2004). It soon became apparent that the rot went much deeper than expected and that what Argentina faced was not a passing phase but a permanent crisis. The remedy devised for Argentina's ills was a series of radical economic reforms. Economists and bankers advocated a restructuring of debt. In December of 2001, minister Cavallo imposed

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unprecedented controls and restrictions on withdrawals. The aim was to prevent the flight of deposits to other countries. Alarmed by the Argentinian government's decision to limit bank withdrawals, the IMF refused to extend a much needed \$1.3 billion loan installment (Independent Evaluation Office 2004).

Violent nationwide protests forced Argentina's President Fernando de la Rúa and finance minister Domingo Cavallo to resign. In January of 2002, newly elected President Eduardo Duhalde announced Argentina's debt default.

### *Debt Default (2002)*

President Duhalde's formal announcement of Argentina's default was expected. Since the beginning of the currency crisis, Argentina's economy had contracted by 11%; its GDP had shrunk by 20%; and unemployment had reached over 20% (Independent Evaluation Office 2004). In January of 2002, President Duhalde ended the peg of the peso to the dollar. This measure led to the substitution of more expensive imports for national product and made Argentinian goods more competitive abroad. Although inflation remained strong, the devaluation of the peso resulted in a growth of national industry followed by a rebound of the Argentinian economy.

Still, Argentina's lost half-decade had deleterious consequences. By 2003, the poverty rate had soared to over 50% (Wikipedia 2013). Even though successive governments had allocated large sums for social welfare and unemployment had shrunk back to pre-crisis levels, today poverty levels are still higher than in 1997. Due to the decline in living standards and the deterioration in human development indicators, economists have aptly named the period between 1997 and 2002 as Argentina's lost half-decade.

### *Summary*

- President Carlos Menem's neoliberal economic program – including privatization, a fixed exchange rate, and foreign direct investment – created a temporary economic miracle.
- By 1997, the combination of the fixed exchange rate and a high fiscal deficit proved unsustainable, resulting in payments disequilibrium.
- Argentina's currency crisis affected all sectors of the economy and society, as demonstrated by the shrinkage of the GDP and the increment in unemployment.
- In 2002, Argentina – the second largest economy in South America – defaulted, resulting in a stagnation of most Latin American economies and a rise in borrowing costs in the region.
- Argentina's economic decline during 1997–2002 was so steep that the United Nations' ECLAC named it the lost half-decade.
- Today, Argentina still suffers from the negative effects of the lost-half decade, including chronic economic crises, high inflation, mounting external debt, and capital flight.

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