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In the wake of the crisis: Argentina's new economic and labour policy directions and their impact

Marta Novick, Carlos Tomada, Mario Damill,
Roberto Frenkel and Roxana Maurizio

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*Marta Novick, Carlos Tomada, Mario Damill,
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Introduction by Juan Somavia

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Preface

This monograph has its origins in two distinct activities of the International Institute for Labour Studies.

The first was a review of the impact of the World Commission on the Social Dimension of Globalization, three years after its report was published. For that purpose, it was decided to examine the experiences of certain countries that have developed new policy approaches which pursue some of the recommendations and goals of the World Commission. Roberto Frenkel and his colleagues at the Centro de Estudios de Estado y Sociedad, Buenos Aires, agreed to prepare a paper examining in depth the changes in macroeconomic policy in Argentina in recent years, following the deep crisis of 2001-02, and their consequences.¹

The second was a plenary presentation by Marta Novick, at the ILS Research Conference in Geneva on December 1, 2006, which explored the extent to which the recent policy developments in Argentina constituted a new economic and social model. In collaboration with Carlos Tomada, Minister of Labour, she has expanded that earlier presentation into a fuller analysis of how decent employment was made an integral part of the overall strategy for growth and development.

The two papers, while initially independent of each other, provide complementary perspectives on recent policy developments in Argentina, and we have combined them in a single monograph, along with an introduction by Juan Somavia, Director-General of the ILO.

¹ The review of the World Commission's work has been circulated as ILS Discussion Paper number 175 under the title "The quest for a fair globalization three years on: Assessing the impact of the World Commission on the Social Dimension of Globalization" by Hamish Jenkins, Eddy Lee and Gerry Rodgers.

The Argentinean experience is of course unique, but then so is every country's experience. And the policy innovations in Argentina have been striking both in their scope and their impact. There are no doubt interesting lessons here for other countries to draw.

Gerry Rodgers

Director

International Institute for Labour Studies

Geneva

August 2007

Introduction

Juan Somavia

The International Labour Organization (ILO) has been concerned with the social consequences of economic processes since its inception. It was created as part of the Treaty of Versailles, which in 1919 marked the end of the First World War, in the spirit that universal and lasting peace could only be achieved on the basis of social justice or, in other words, a decent life for people. Trade competition between the main developed countries, which intensified during the first era of globalization of the world economy at the end of the 19th century, along with deep class divides, had left workers mired in a state of exploitation and deprivation which was both morally unacceptable and politically unsustainable. At that time, an undercurrent brought to the surface what was later to be called the “social question”. Thus was born the ILO.

Nevertheless, the world had to endure the great Depression of the 1930s and another world war before entering an era of economic progress and social advance. The ILO’s pioneering work began to bear fruit and the strength of its labour standards made a considerable contribution to a constantly improving quality of life for much of the developed world for some decades. Meanwhile, another important part of the world was hoping to embark on this new path. In the mid-seventies, the oil crisis, and then the debt crisis of the eighties, ushered in a new era in the world economy which put a brake on the economic growth which had seemed inexhaustible and gave way to a process of global adjustment.

A second wave of globalization then began, accompanied by a range of structural adjustment policies. These policies were intended, on the one hand, to give a target for flows of capital and goods from the devel-

oped countries and, on the other, it was argued, to strengthen the economies of developing countries. Free markets were seen as the primary means to achieve growth and assure social stability and political democracy. Policies that promoted deregulation, privatization, open trade and liberalization of financial flows reinforced the process of globalization, which affected both developed and developing countries. Its effects were unequal and favoured the strongest — people, companies and countries — who could take advantage of the new rules. Many people suffered in the process.

The ILO monitored all these developments with a critical eye, promoting the inclusion of social and labour dimensions in a process otherwise centred on trade liberalization and integration, with the aim of correcting the perceived tendency for the process to generate unequal results. Moreover, unbalanced economic reforms and adjustment processes, based on a simplistic and purely economic vision of social and political change, led the ILO to stress the need for an integrated approach to public policies to take account of the social dimension, consistent with the objectives of the ILO enshrined in its Constitution and the Declaration of Philadelphia (1944), which even then maintained the need for greater coherence between economic and social policies as the basis of social justice and fairness. The Decent Work Agenda, defined by the ILO and increasingly adopted by the international community, with its four strategic objectives (labour standards and rights, job creation and enterprise development, social protection and social dialogue) highlighted the importance of work and the main actors, workers and employers. It reiterated the need to ensure *quality* employment, as well as to promote economic growth with *more* employment.

Increasingly, ILO's advocacy of the need to include concern for people, i.e. the social and labour dimension, in the new international economy opened the way to the notion of the Social Dimension of Globalization. In 2002, the perception that globalization was both inevitable and an opportunity for change, led the ILO to set up a Commission which could analyse its main characteristics and give it a new perspective. Thus was born the World Commission on the Social Dimension of Globalization, which sought to re-think these issues and move away from the narrow preoccupation with markets to a broader concern with people, their families and the communities in which they live.

The report of the World Commission set a new challenge for the ILO and those States concerned to change the direction of globalization.

For the ILO, it meant the start of a period of follow up to the Commission's recommendations and support to national responses to the challenges of globalization. States, for their part, had to move from the general level of objectives and principles established in the Report to the application of specific public policies to pursue these goals. These public policies included the promotion of good national governance through the strengthening of institutions supporting and supervising markets, the identification of decent work as a fundamental objective of economic policy, the reinforced priority of job creation, the promotion of fair rules in trade, global production systems and the international financial system, as well as efforts to achieve better international policies and more responsible multilateral institutions and non-governmental actors.

This book presents an invaluable experience, both of the impact that globalization, when based only on market liberalization, can have on an economy and a society which was seen to possess a relatively developed welfare State, and of a remarkable national response to the challenges of globalization. Due to the speed of implementation of the policies of adjustment and structural reform during the 1990s, Argentina became an exemplary model of the implementation of adjustment policies in the eyes of the international financial institutions. The consequence of those policies was not, as had been foreseen, entry into the select club of developed countries, but instead a deterioration of all social and labour indicators: more poverty; more exclusion; and more unemployment. The ensuing political, economic and social crisis seemed fatal.

Argentina's journey up to 2001 alone deserves to make this country a case study. It continues to be that, but for the opposite reason. Since 2001, Argentina has achieved strong economic growth — almost 40 per cent of GDP — together with a substantial improvement in all social and labour indicators, which has aroused enormous interest. As can be seen from the contributions in this book, public policy in Argentina since 2003 was inspired by the concept of decent work. Indeed, Argentina was the first Latin American country to make decent work an objective of its labour legislation and public policy. This was also accompanied by the integration and articulation of economic and labour policies which provided the foundation for a growth model which was fed by a virtuous circle of demand, employment and investment.

The objective of generating decent work as the focus of economic and labour policies was supported by an economic model based on a competitive exchange rate and emphasis on the generation of a consoli-

dated fiscal and trade surplus, in turn supported by a strong incomes policy for workers and their families which would revive the importance of the domestic market as the driver of demand.

Furthermore, the focus on people and respect for their fundamental rights as a basic need and ultimate policy goal, and the restoration of labour legislation, social protection and promotion of social dialogue as redistributive tools, all formed part of the package of initiatives developed by Argentina in these three years. All these aspects taken together, and this is something new, point to a strong and efficient State which allowed the country to make a rapid recovery from the most devastating effects of the crisis.

Of course, in many ways the international climate was favourable. Nevertheless, it must be emphasized that, thanks to the implementation of these policies, Argentina has been able to return to the path of economic growth with a performance achieved by very few other countries in this period, and has combined this development with significant improvement in labour protection and social security indicators. The reduction in poverty and extreme poverty, lower unemployment, rising real wages, wider coverage of collective bargaining and the control of unregistered work, all bear witness to this progress. There still remain many challenges ahead, but the progress so far is certainly significant.

Although, as the report of the World Commission points out, there is no universal policy agenda applicable to all nations, recent experiences such as that of Argentina give grounds for optimism about the possibility for the world to move towards a development and growth model which, in the spirit of the ILO Constitution and the Declaration of Philadelphia, make social justice and equity the basis of world peace. In such a model, economic competition in a globalized world is part of a virtuous circle in which greater equality among nations occurs as the result of a drive towards greater protection and security of their workers and, thus, a better quality of life for their citizens, reinforcing the strength and sustainability of fair and participatory democracies.

The two papers in this volume provide in-depth information on, and analysis of, the policy shifts in Argentina in the wake of the 2001 economic crisis and their impact. The first paper, by Marta Novick and Carlos Tomada, discusses the adaptation of the development model as a whole, and the attempt to integrate economic and social goals in general, and decent work in particular, within a coherent policy framework. The

second paper, by Mario Damill, Roberto Frenkel and Roxana Maurizio, explores in some depth a crucial dimension of the policy response, concerned with macroeconomic management. Together these papers, whose authors include both independent academics and key policy actors, provide valuable insights into the options, the strategies adopted and their results.

Argentina 2003-2006:

Economic growth with decent work

A new model for Latin America?

*Marta Novick*¹

*Carlos Tomada*²

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² Lawyer, former Director of Labour Relations in the University of Buenos Aires. Currently Minister of Labour, Employment and Social Security of the Republic of Argentina 2003-2007, former president of the ILO Governing Body 2005-2006.

Executive summary

This article discusses the strategy implemented by Argentina to overcome the greatest economic and social crisis in its history (2001-2002). This strategy involved a new configuration of social and economic policies that are relevant to the global debate on economic and social models, especially in Europe.

To that end, the study asks whether one may attribute Argentina's recovery to a new economic and social model or merely a favourable international economic climate. The study briefly analyses the evolution of Argentina's development model, focusing on the policies of deregulation and flexibility implemented in the 1990s, showing their consequences in terms of unemployment, precariousness and an increase in inequality and income distribution. These policies led to the marginalization and exclusion of many sectors of the population and an unprecedented political, economic and social crisis, which undermined the foundations of social citizenship and contributed to institutional volatility and collapse.

In order to exit from this recessionary context, a particular monetary policy was implemented that instituted a competitive, floating and stable exchange rate, which helped re-establish labour-intensive production chains and import substitution activities. The analysis of the new strategy is centred basically on the following aspects:

1. Macro-economic strategies: the principal economic and labour policies implemented.
2. Legislative changes.
3. Rebuilding of labour institutions, including restoration of the capacity for labour inspection, promotion of collective bargaining and extension of its coverage.
4. Wage policy based on strategies differentiated according to the stage in the economic cycle, with core emphasis on the minimum, living and adjustable wage.
5. Employment policy aimed at public intervention in the labour market at local level, and change of direction in vocational training rooted at sectoral and/or territorial level.

This article describes and analyses a cornerstone of the implementation of these actions, namely the coherent and systematic effort to inte-

grate policies, both at national and international level, based upon the premise that the links between the different actors, social solidarity and economic efficiency are fundamental to compensating the market limitations.

The work shows how the abandonment of the Convertibility exchange rate regime in 2002 gave rise to a change in relative prices which allowed the pattern of growth to be directed towards a more integrated approach that incorporated the excluded members of the labour force by generating employment. The results have yielded a significant rise in job creation, reduction in unregistered labour, and productivity increases.

The article, above all, asks whether or not this recovery is the fruit of a new configuration of economic and social policies. Other pending issues include uncertainties related to the State's discretionary actions, the strategies of the actors involved in this process and the persistence of behaviour inherited from previous models. This document ends with a series of questions arising from this pending agenda and the need to reinforce and/or create new institutions to strengthen this agenda.

Introduction

After more than two decades marked by the rise of a growth paradigm based on the free operation of markets, its limitations have generated a debate on how to define a new model that would meet the challenges brought about by a phase of deregulation, market opening and structural adjustment, which superseded the previous so-called Welfare State.

Despite the fact that in the last two decades Latin America also experienced the shift from a particular model of a regulated economy and its own kind of Welfare State to a free market model, this process took place without sufficient debate. In Europe, there is intense and in-depth discussion driven by political and social integration into a single region and economic competition with other actors in the international economy. Nevertheless, its importance transcends the bounds of this geographical area and affects a variety of countries, developed and developing, with dissimilar structural characteristics and that are unequally integrated in a globalized world.

In the context of this debate, Argentina's experience allows us to analyse whether what we are witnessing is indeed the emergence of a new model of economic and labour policy. The Argentine case offers a representative example of the dilemmas facing Europe. Argentine society was characterized by a relatively high level of human development, with a broad system of social protection, considerable human capital, and a slowly but constantly growing economy. From 1976 onwards, it was faced with a process of economic openness and deregulation and the consequent dismantling of the existing industrial structure and its Welfare State.

Twenty-five years on, this neo-liberal economic and social model entered a profound crisis. Today, with a new political landscape, strong economic growth and a real improvement in all the social indicators, the discussion is about whether this is indeed a new paradigm of economic and social development. The new pattern of growth offers a virtuous circle combining greater aggregate demand, productivity gains, more decent work, better income distribution and poverty reduction. It marks a return to active policies and the integration of economic and social policies which gave rise to the recovery of labour institutions and the domestic market. Yet this new pattern of growth raises not just one but a number of questions. Is it pointing the way towards a model of economic

growth based on productivity, new technologies, human capital and flexible approaches to labour relations combined with broad social protection? Or is it a model that is similar in economic terms, but with a return to strong labour institutions, robust labour relations, active trade union involvement and social protection — in contrast to global trends and current patterns in the world economy? Furthermore, is it sustainable or merely the transitory effects of a favourable cycle in the world economy which gives the space to apply policies that differ from those prevalent at global level, but whose continuity would be associated exclusively with that favourable international context or contingent short term policies?

This study is an endeavour to contribute to this debate. It is structured as follows. The first section briefly presents the discussion which is taking place in Europe concerning models and their relevance for Latin America. In the second we go on to describe the Argentine experience in the last decade. In the third section, we embark on the analysis of recent economic policy and its results, and in the fourth section, labour policies implemented. We conclude with the outstanding agenda and the conclusions.

The European debate and its relevance for Latin America

An interesting debate about contemporary political, economic and social models has been in part spurred by the relative stagnation of economic growth in Europe and the process of integration in that continent.

These models reflect a given configuration between economic, political and social dimensions. Being by their nature interpretative conceptual systems, they are not applied universally but adapted to local or national peculiarities.

In broad terms, the principal paradigms are, on one side, the free market socio-economic model and, on the other, the regulated economy model supplemented by a highly protective social system. In its most recent version, the former is represented by a growth model based on maximizing capital gains, which requires flexibilization of employment and wages. In consequence, it produces work which is precarious in nature³ and relies on individuals taking responsibility for finding a place

³ This emphasis is summarized in the phrase that the creation of any job is better than none. See Thomson, Stuart (2000) *The Social Democratic Dilemma* (Macmillan: Basingstoke).

in the labour market, personal development and social security. Consequently, it is supplemented by a social protection system of “last resort” which is also very limited in time and coverage. Today its most prominent exponent is the United States.

The second model, where the emphasis is on economic and social citizenship, postulates regulation of markets and strong principles of social solidarity, which constitute its core values (Schweiger and Wickham, 2004:17). Economic growth is sustained by the domestic market, while its solidarity-based social security system with broad coverage against social risks promotes citizen participation and is financed through redistributive taxes. Thus, by attracting investment, labour, knowledge and innovation as the engines of growth and the creation of more and higher quality jobs, the European Employment Strategy is a clear example of this. In this respect, the institutional articulation between economic and social systems is crucial. According to Ocampo (2006a), the cornerstone of this relationship is human development, the capacity to provide and organize resources, opportunities to generate sufficient income and manage risks.

These paradigms have both been open to question. The criticisms of the neo-liberal model are for the most part familiar to the majority of specialists. Its effects in terms of poverty, inequality and exclusion have shown its weaknesses and how destructive it can be for developing countries.

This package of market reforms, known as the “Washington Consensus”, constituted an incomplete agenda as it did not take account of the role of institutions in economic development and tended to minimize the role of social policy. Many countries in recent decades, both in Latin America and in other regions of the developing world, have also faced new layers of institutional conditionality in obtaining international financial support, and suffered poor economic performance and a deterioration in wealth distribution, underlining the fact that there is no single path to development (Ocampo, 2006a).

For its part, the Welfare State in Europe has entered into crisis for a variety of reasons, among them the erosion of the traditional mechanisms for financing social security (due to ageing of the population), commercial and financial globalization, a decline in the growth rate and greater diversity in patterns of employment (Boyer, 2007:13). The simultaneous objectives of social solidarity and economic efficiency and compensating for the limitations of the market have become irreconcilable.

Universal and broad social protection, characteristic of Europe, is no longer financially viable, which is why recent initiatives have sought to reduce the burden on public finances. Measures such as “activation”, terms such as “employability” and “targeting” are becoming the norm in Europe (Auer, 2006:46).

Some authors maintain that the process of European integration combined with a degree of economic stagnation and high unemployment has encouraged the proliferation of powerful interests in favour of rapid union in a large market without barriers. They have succeeded, by act or omission, in delaying the process of community harmonization of social standards; these are inevitably linked to economic performance, which has been unsatisfactory (Schweiger and Wickham, 2004:28, Fitoussi, 2007). Nilssen (2006) states that, with the emphasis on “activation” of individuals and “targeting”, when European authorities talk about coordination of social aspects, they have shifted their approach from social policy to labour market policy.

These interest groups, supported by a widespread perception that the traditional Welfare State is not financially viable, argue that free trade will allow both better allocation of resources and recovery of economic growth and an increase in employment and competitiveness in relation to the USA or the Asian countries. As they see it, social risks (such as poverty and exclusion) will be reduced by greater job opportunities or offset by a targeted social safety net system, with a lower level of protection, which also means a reduction in government social spending, especially that associated with unemployment. The model that they are promoting is one of “*workfare*”, North American style, instead of “*welfare*”⁴ traditional to the European experience.

Other voices recognize the difficulties experienced by the Welfare State but stress the need to find other ways to adjust social protection coverage in function of an economic system which yields far more modest and uncertain growth. They uphold the importance of an “Active Social State” whose characteristics distinguish it both from the former Welfare State and from the Anglo-Saxon *workfare* model. It differs from the Welfare State by the current need for strong intervention on matters related to employability, and a greater pursuit of flexibility in labour relations to

⁴ The term *workfare* means “work for your welfare” and is replacing the term “*welfare*”, which refers to a universal system of social protection which is more or less unlimited.

adapt to technological and economic changes and tackle the new challenges of globalization. It is distinguished from the *workfare* model in that it maintains a broadly cohesive and solidarity-based approach to social risks. The new model of the Active Social State is represented by some Nordic countries, such as Sweden, Denmark and Finland (Boyer, 2007:20). In the Danish case, for example, the approach is conceptualized as *flexicurity* (Auer, 2006), a term which means a combination of flexibility and security. Restrictions on hiring and dismissal are reduced or eliminated, while at the same time unemployment indemnities are kept at a high level. As well as justifying it on ethical grounds, these authors affirm that long-term economic growth is more sustainable due to the combined strategic advantages of State regulation of training and the development of human capital, in contrast to private or individual mechanisms (Boyer, 2006). There are those who question whether it is possible to develop an economic model which provides social protection in a neo-liberal world characterized by unlimited economic competition (Reinert, 2006).

The fact is that European countries, like many others, have slowly begun to improve their job creation performance. However, atypical and precarious forms of employment have also increased. The risks of this process are such as to undermine the bases of economic and social citizenship and limit the accumulation of human capital, and ultimately economic growth and employment in the long term (OECD, 2006a: 150).

What hangs in the balance in the current European integration process — and for the fate of Europe itself — is whether we will witness the consolidation at global level of an economic-social model driven by capital and the subordination of employment and work, or the development of another model where all these elements manage to cohabit in a more productive combination. However, in a context of openness and commercial and financial globalization, the latter would inevitably have to differ from past experience.

It is worth highlighting that while the debate on the crisis of the “European economic and social model” and its divergent future prospects continues, Latin America is currently witnessing a change of political signals from its governments. This is following the rapid and profound collapse of the neo-liberal policies which had replaced almost fifty years of a Latin American “quasi-Welfare State”. The pace, depth and failure of existing paradigms confronted the region with the challenge of finding a model which could satisfy two conditions at least. It must restore the role

of the State in meeting the strong social demands for inclusion and social protection. At the same time, it must achieve economic growth and successful participation in a globalized world. This means developing a new model which, as before, will be different from those that exist now.

Indeed, historically in Latin America, the characteristics of the Welfare State were very different from those of the European countries. It was marked by policies which in the majority of cases could not achieve social inclusion for the population as a whole. Some countries progressed towards a degree of social homogeneity greater than others, but the State had a more interventionist role in the economic field, not only as a general regulator of the economy but also as employer.

Similarly, the application of so-called “Fordism” in Latin America did not fulfil two of its basic requirements: mass production and large consumer markets. These existed only to a limited degree and were confined to a few regions and industrial sectors (Novick, 2000). The peculiarities of the way this welfare “model” was adapted to the Latin American context were due to a series of reasons which are beyond our remit here to discuss. However, we wish to emphasize that it was only partially and unequally applied and ultimately results differed widely. The Latin American economy performed poorly during the decades prior to 1973, the stated objectives of a self-sufficient development path were not achieved, while at the same time global trade was growing by leaps and bounds without the region's participation. In the specific case of Argentina, which in the early 70s seemed to be in a position to embark on such a path, the imposition of a military dictatorship which carried out an early experiment in neo-liberal reforms (known as “monetarist” at the time) blocked this possibility.

Subsequently, the implementation in Latin-American countries of the neo-liberal policies of the nineties also had original features. Latin America stood out as the region which, after decades of a closed economic system and major State intervention, applied a set of structural adjustment policies with enormous speed and depth. It did so through indiscriminate economic liberalization, privatization of public enterprises, commercial openness and withdrawal of the State. 1998 saw record revenues from privatizations for the decade in Latin America. In that year, the countries in the “first wave” of privatizations (Argentina, Chile, Peru, Mexico) had already privatized the majority of their public enterprises and several of them (Argentina, Bolivia, Brazil, Chile, Colombia, El Salvador, Mexico, Peru and Uruguay) had also reformed their social security

systems (ECLAC, 1999). This shows the pace at which the reform was implemented. The region was then a testing ground for the implementation of the policies that emerged from the Washington Consensus⁵ and which were to herald a prosperous future. However, from 1998 to 2000 the number of people living in poverty rose throughout Latin America to 75 million, and now to over 200 million. Of the total number of the new poor in the region, almost 95 per cent were urban poor. The economic liberalization programmes added not only to the levels of poverty and extreme poverty, but dramatically increased the indicators of economic and social inequality. Another interesting indicator of the performance of the neo-liberal policies is that in the early seventies, the increase in regional product was 6 per cent annually, while at the end of that decade it had fallen to 1.5 per cent and in the eighties, the Latin American economies failed to grow. Average annual growth during the 90s was 3.2 per cent. The average annual rate of growth of per capita income was 3.1 per cent between 1945 and 1980, 1.9 per cent in the seven years following the lost decade of the eighties and 0.5 per cent from 1998 to 2004 (Cimoli *et al*, 2006).

The economic and social models implemented throughout the nineties in a great many Latin American countries (albeit with considerable differences between them) significantly affected existing forms of organization (productive, social and economic). At aggregate level, the various policies had a common thread centred on the need to accelerate improvements in competitiveness and productivity under the strategy of openness to international markets for goods, services, technology and capital. It was assumed that these measures would lead to a recovery of the productive dynamism which had fallen into crisis in the last phase of the import substitution model.⁶ In particular, it was said that deregulation of the labour market would lead to an improvement both in the quantity and quality of employment, through reallocation of resources and new productive specialization.

Interest shifted away from the previous goal of full employment and towards making the labour market subordinate to the emerging requirements for change in the structure of a free market economy. As a result

⁵ A set of political and economic reforms which, since the late 80s, primarily defined the doctrine promoted by the richest countries and multilateral lending institutions with respect to developing countries.

⁶ It should be noted that these changes took place simultaneously with the growing consolidation of technical and organizational change which tended to establish activities and patterns of organization of production different from those established in the previous phase.

of this, unemployment indicators soared to unprecedented levels while key industries underwent a devastating de- or re-structuring of their productive chains (weakening or disappearance of supply networks, greater imports of inputs, etc.) (Bisang *et al*, 2005).

Meanwhile, during these years, conditions were being created at international level such that the world economy would cease to be an aggregation of national economies linked by trade flows, investment and financing. Instead, it would be progressively transformed into a series of global networks of markets and production which cut across national borders. However, these processes, which were undoubtedly growing in strength, were not matched by an equivalent development of global institutions, for which the agenda is still incomplete and unbalanced (Ocampo *et al*, 2004).

Globalization did not produce the promised homogenization of the world economy. On the contrary, it translated into an unequal, segmented and multi-dimensional process. For the World Commission on the Social Dimension of Globalization, the consequence of this inequality was to produce gaps in employment, social protection and social dialogue (ILO, 2004). The widening of these gaps increased the inequalities between countries and in many cases within countries as well, with the consequent effect of social polarization.

The crisis of the neo-liberal project in Latin America generated a series of social demands and produced a new political phase which led to a review of both the models and policies of the past decade, and the very notion of the State and its role in economic affairs and labour policy. Employment, a variable hitherto considered as an “automatic” element of adjustment that would inevitably accompany macro social changes, has been restored — partially at least — and in some countries, it has taken central stage. “Employment at the centre of policy”⁷ became a new goal in the changing political and economic scene, vindicating the ILO concept of “decent work” which the ILO sought to imbue with new meaning at the end of the nineties.

Thus, in recent years Latin America has undergone a strong recovery. Nor did this consist merely of achieving a series of socio-economic

⁷ As was the title of the hemispheric Mar del Plata Summit in November 2005 “Creating Jobs to Fight Poverty and Strengthen Democratic Governance”.

indicators⁸ at levels similar to those for the period prior to the debt crisis. On the contrary, it also included restoration of the role of the State as the mediator in social conflicts and guarantor of reproduction of the system. In addition, the increase in the prices of exportable products, such as oil (Venezuela), copper (Chile), in the hands of the public sector, or in those where the State could indirectly associate itself through taxation, (soya, vegetable oil and meat in Argentina) allowed it to strengthen its authority over domestic and international social actors and expand its freedom in macro-economic and social policy. The expansion of the domestic market combined with the increase in public investment were central factors in this recovery of the State's capacity.

Some of these countries, such as Argentina, Brazil and Uruguay (within the context of their respective particularities, differences and obstacles they face) are also reviving their labour institutions and, very slowly, the importance of the role of trade unions and the central role of social protection is regaining ground (Bensusan, 2006: 25-26).

The experience of Latin America has thus tended to lead to particular adaptations of the economic and social models of each historical era. This can be explained by the different economic, political and social contexts in which these different paradigms were developed and introduced. The pace of change was also a notable characteristic. In the last sixty years the region has gone through the implementation of its own particular model of the Welfare State to the full application of the neo-liberal paradigm. In a number of social and economic domains, policies were changed to varying degrees and in others retained.

The Argentine experience prior to 2003

In terms of adapting systems, Argentina was no exception to what happened in Latin America as a whole. The import substitution model (1930-1976) was developed on the basis of a closed economy which allowed modest growth but did not involve policies to stimulate competition, innovation and productivity (López, 2006). In the tradable sector, innovation was associated with incremental models and more traditional adaptation (Katz, 1986).

⁸ The rate of growth of GDP is around 5 per cent annually, poverty levels are similar to those of a quarter of a century earlier and GDP per inhabitant in 2005 is 11 per cent higher than in 1980 (Ocampo, 2006b).

Despite the general perception at the time, the result was rather poor if set against an international scene which, conversely, was going through a “golden age” — with the highest ever growth rates for production, trade and investment, full employment, low inflation and a constant rise in people’s living standards (López, 2006). From these, Argentina failed to benefit.

Despite the mediocre economic performance, this model incorporated integrated social, sectoral and geographical linkages, an institutional structure like “Chinese boxes” each fitting inside the next. Employment and conditions of work were linked to the economic cycle, characterized by full employment albeit with slight and short-lived periods of frictional unemployment. Although there was no European-style Welfare State as such but an adapted version of it, social protection in its various forms was consolidated and considerable — even though it was very often associated with entry into the labour market. Health, education, social security and housing were provided or subsidized by the public sector. Levels of exclusion and poverty were low and were accompanied by a traditionally strong sense of equality, rights and social citizenship, derived from the upward social mobility which for a long time set Argentina apart. This in turn reflected a highly egalitarian functional and personal distribution of incomes.

State autonomy was relatively low and, despite its strong economic and social presence, the State was at the mercy of pressures from the various social sectors struggling and jostling among themselves for wealth distribution. This was reflected in a high level of institutional volatility, the result of political changes and interruptions to the democratic cycle accompanied by economic instability and uncertainty resulting from the “stop/go” Argentine economy and the lack of clear agreement on a development model (López 2006). In general, these cycles were associated with the country’s external performance, and the crises were linked with balance of payments problems (Díaz-Alejandro, 1975).

In 1976, a new phase began which lasted until 2001⁹. It enshrined not only the elements of a different type of economic policy, but also dramatic political changes due to the breakdown of the democratic system (in 1976) and the fierce repression unleashed against vast social sectors, in a climate of human rights violations which also had ethical, moral and

⁹ A period which Andrés López characterizes as one of “reform” and which is divided into two main sub-phases, one running from 1976 to 1990 followed by a second sub-period of “convertibility”.

social consequences. Simultaneously, there was a collapse of the economic model and the political model with the opening of the economy, deregulation and the collapse of democratic institutions. All this came at a time when the world economy was suffering from a major shock due to the oil crisis and the changing technological paradigm. It marked a turning point in Argentine history.

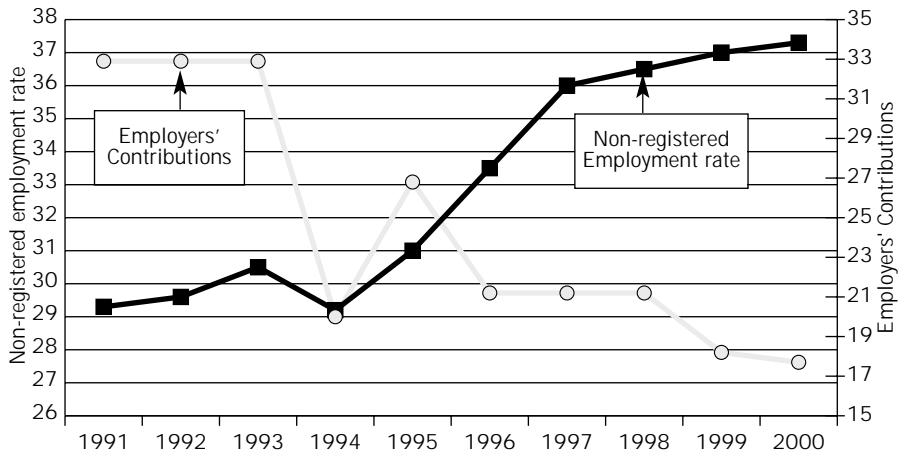
As López points out, *per capita* GDP in the period 1976-1990 was 23 per cent lower than in 1975. In the first phase of convertibility (1991-1995), the path of growth resumed (5 per cent annual average). This, however, was not reflected in employment, but was rather accompanied by a tripling of the unemployment rate. The return to growth came to a halt, first under the “*post tequila*” effect (following the Mexican crisis) and then fell between 1998 and 2000 GDP by a cumulative annual average of 3 per cent.

Prominent among the economic and social phenomena recorded during this long period is deregulation of the labour market, the negative impact of which was reflected in the increase in unemployment, the regressive distribution of income and the increase in poverty. This process was particularly profound and also had “perverse” consequences. For example, while the Government was trying to reduce labour costs, by reducing the contributions that companies had to make to the social security system for the workers employed by them, the unregistered employment rate rose from 29.6 per cent in 1991 to 37.3 per cent in 2000 and continued rising to 44.8 per cent in May 2003. With the same objective, successive reforms of labour laws allowed and stimulated the spread of atypical and precarious forms of employment, in many cases highly unstable. This ultimately led to a highly polarized, segmented and heterogeneous labour market, where employment contracts for an indefinite period of time rapidly ceased to be the norm.

Social security institutions (pensions and health, among others) suffered major adjustments in line with these new forms of labour relations and incorporated new arrangements such as privatization. In this respect, there was a move towards forms of individual management of social risks such as health, old age, etc., thereby breaking with one of the basic principles of social security characteristic of the most advanced systems, namely solidarity within and between generations, (Roca, 2005).

The impact of a pattern of low growth on employment levels was dramatic, raising unemployment rates to levels never before recorded,

Non-registered employment rate and average employers' contributions



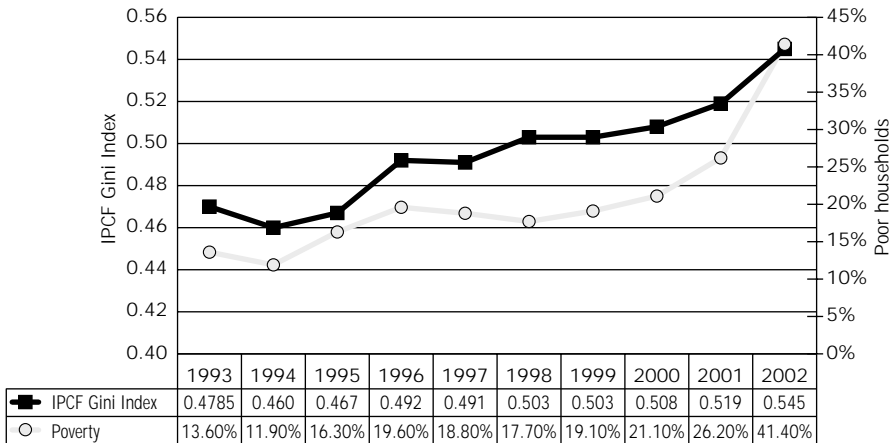
Fuente: SPTyEL – DGEyEL

rising in October 1995 to 18.5 per cent. During the 2001-2002 crisis, this percentage rose even further, to 21.5 per cent.

Another effect of the rise in the unemployment rate and the strong increase in precarious employment was to reduce the scope of collective bargaining and increase the lack of worker protection. A conflicting trend was observed in the nineties between an increase in negotiations on the quantity, quality and renewal of certain labour agreements and persistence of the “ultra-activity¹⁰” of the most important agreements reached in the 1975 bargaining round. In addition, collective bargaining shifted downwards from the area of activity or productive sector to company level: between 1991 and 1994, 65 per cent of collective agreements and covenants were at sectoral or activity level and between 1995-1999, 78 per cent of bargaining was at company level and 22 per cent at sectoral or activity level. Wage bargaining was concentrated in only a few groups, while in the remainder wage clauses were not discussed, only flexibilization of conditions of work (working time, organization of work) (Novick and Trajtemberg, 1999). During 2001 and 2002, bargaining was

¹⁰ Ultra-activity: under law 14.250 on collective bargaining, collective labour agreements remain valid beyond their agreed term if the agreement is not renewed or replaced. This explains why some important sectoral agreements negotiated in 1975, which have not been renegotiated since, remain in place.

Increase in poverty and deterioration of income distribution between 1993 and 2002



IPCF: Family income per capita. Source Permanent Household Survey (EPH) specific, National Institute of Statistics and Censuses (INDEC)

characterized as “crisis bargaining” under the “Crisis Prevention Procedures” (PPC), which facilitated bargaining in cases of bankruptcy, downsizing or extreme situations in companies. While the ratio of PPC to collective agreements was usually low and rarely exceeded the number of agreements, in 2002 the crisis procedures were three times the latter (664 PPC and 202 collective agreements) (Novick and Trajtemberg, 2005).

Finally, the consequences of the reduction in jobs led to a weakening of institutions historically linked to employment: fair wages, social security, collective bargaining, etc. and were devastating for Argentine society. The percentage of poor households increased from 16.3 per cent in 1993 to 41.4 per cent in 2002 and those who did not have access to a basic shopping basket of food, the extreme poor, increased more than five-fold, from 3 per cent in 1993 to 18 per cent in 2002. In addition, the increase in inequality, which recorded unprecedented levels compared with historic trends¹¹, was dividing society and excluding vast sectors of the population, despite significant rates of economic growth in some brief periods.

In other words, the policies implemented meant marginalization and exclusion of many sectors of the population. It led to an unprece-

¹¹ The Gini index rose from 0.455 in 1993 to 0.502 in 2002.

dented political, economic and social crisis, undermining the bases of the social citizenship achieved hitherto. In this regard, it can be stated that over half of Argentines lost their citizen status in that decade because they were without employment, social protection, and because of the deterioration in public health and education etc.

The crisis of 2001 which ended the Convertibility regime and brought about the downfall of the radical government led to a mega-devaluation, the biggest default in international history, a spectacular fall in GDP and collapse of the financial system. The social disaster was of unparalleled magnitude.

Macro-economic policy and the role of labour

The abandonment of Convertibility from 2002 generated a change in relative prices which allowed the pattern of growth to be aimed towards more integration, incorporating the excluded sectors by means of job creation. The public policies implemented since 2003 introduced a new concept of work, not as a labour market problem but as a linking factor between the economic and social sphere, the basis of social cohesion, a source of personal worth and a constituent factor of citizenship. The approach which guided the growth policy was to consider employment as the principal engine of wealth creation, through which men and women maintain their families, and a basic instrument of social progress (Carnegie Council, 2005). To make that possible, it was also necessary that it was not just “any work”, but decent work, i.e. protected, productive, providing a decent income to the worker.

Achieving these objectives required the simultaneous application of a series of macro-economic measures to promote economic growth and more employment. It also required a change in policy direction, restoring and redefining the role and authority of the State and developing active policies in a number of areas. Basically, it meant linking economic, labour and social policies to transform production, create decent jobs, improve incomes and incomes distribution and, ultimately, patterns of consumption, and also stimulate social mobility.

In order to exit from the recession, a competitive exchange rate policy was implemented in relation to the trading partners, which was both floating and stable in purchasing power terms. Some studies — Frenkel (2003), Frenkel and Taylor (2006) and Frenkel and Ros

(2004) — show that the exchange rate has impacts on employment which can be seen through three channels of influence. The first of them, the *macro-economic*, is provided by local firms which recover international competitiveness in the short term. This, accompanied by appropriate fiscal and monetary policies, facilitates a new level of activity, which allows the hiring of new workers after the use of overtime has been exhausted¹².

A second channel is *development* which is similar to the use of industrial promotion incentives which achieve virtual import substitution. *Development* protects domestic production and also generates an impetus to conquer external markets, which can act on employment in the long term through the incentive to production and export of tradable, manufactured goods and upstream and downstream chains (suppliers and customers). It operates in the medium term.

The third channel, longer term, which the authors characterize as *labour intensity* (which we could call productivity, as it redefines the role of work *vis-à-vis* technology) protects domestic production in practice and induces the use of appropriate technologies which do not discriminate against labour.

The new relative prices following the devaluation encouraged domestic production and increased the competitiveness of Argentine industry. For the first time in Argentina's history, the nominal devaluation of the currency was a success in maintaining itself in real terms. The increase in the exchange rate was only partially transmitted into prices (*pass-through*), unlike in the previous huge fall in activity and vast unemployment. Gerchunoff (2006) maintains that this was also related to the fact that Argentina does not export one basket of wage goods only.

The high exchange rate promoted the re-establishment of productive chains and labour-intensive activities in import substitution. The shortage of alternative investments in other financial assets also led to the promotion of activities such as construction, all of which produced an increase in employment-product elasticity. This was 0.62 in the period 2003-2006, while in the ten years of convertibility, it had averaged 0.45. The international climate favoured this economic growth, although

¹² This assertion was confirmed by a longitudinal study of data from the Survey of Labour Indicators, "Two years of employment growth", in *Trabajo, ocupación e ingresos*, No. 1, April 2005, Ministry of Labour, Employment and Social Security, which analysed how in the first stage of growth, the number of hours worked increased, before being converted subsequently into new jobs.

domestic factors were the key to recovery (Damill, Frenkel and Maurizio, in this volume). The dynamism of private consumption, stabilization of the currency market, the distributive impact of social plans, such as the Unemployed Heads of Household Plan (*Plan Jefas y Jefes de Hogar Desocupados*— PJJHD), incomes policy, collective bargaining and social dialogue were the bases of the return to growth. Recently in a subsequent phase, the contribution of net exports and low international interest rates were included as other pillars of the process (Damill, Frenkel, and Maurizio, in this volume).

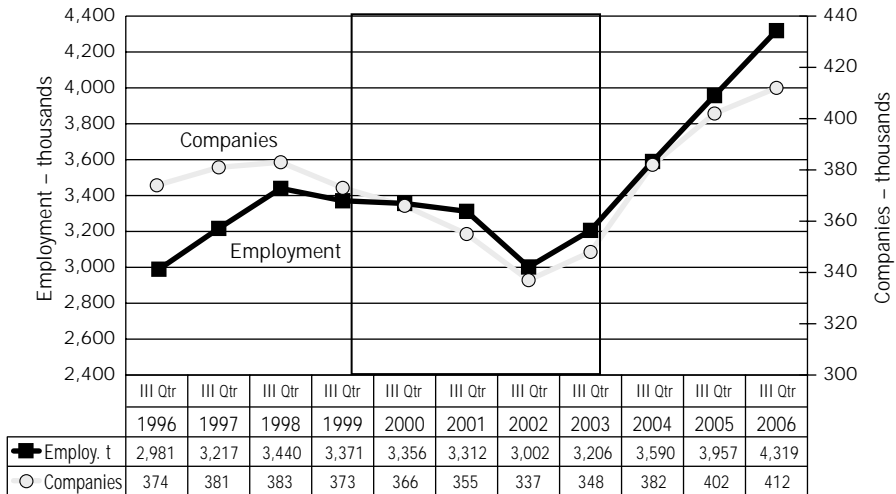
As a consequence, the economy has grown at a rate of around 9 per cent annually during the last four years and preliminary estimates forecast a similar level for 2007. In the same period, industry grew by 11 per cent annually. Export sector performance in an international market with high prices for exportable products was another pillar of growth. In the last four years, exports grew by 84 per cent, while imports, which also rose, were mainly incorporated in capital and intermediate goods (Ministry of the Economy and Planning — MECON, 2007).

This macro-economic policy was not without its critics. From the first references to a simple and passing economic “rebound” after the crisis, to the favourable international climate as the only main reason, the majority of mainstream international and local economic commentators questioned the strategy adopted. It should be emphasized, however, that not all countries drew equal benefit from the favourable evolution of the international economy. Among Latin American and Caribbean countries generally, only Argentina achieved these rates of GDP growth¹³, which can reasonably be attributed to the effectiveness of the policies implemented.

The full impact of economic growth is shown in the statistics on company formations and closures in the various phases, and their impact on employment overall. Following a long period of jobs losses and company closures, recovery can be seen in both from 2002 onwards, accelerating in 2003. Net company formations reached 66,000 in the period 2003-2006. At the same time, the average number of workers per company gradually rose as a result of the expanded use of installed capacity and the number of firms’ creative jobs.

¹³ See ECLAC, *Economic Survey of Latin America and the Caribbean, 2005-2006* for indicators of GDP growth in the countries of Latin America up to 2005.

**Evolution of private companies and employment in industry, trade and services.
Third quarter 1996-2006, in thousands of companies and employed workers**



Note: The shaded area represents periods of recession

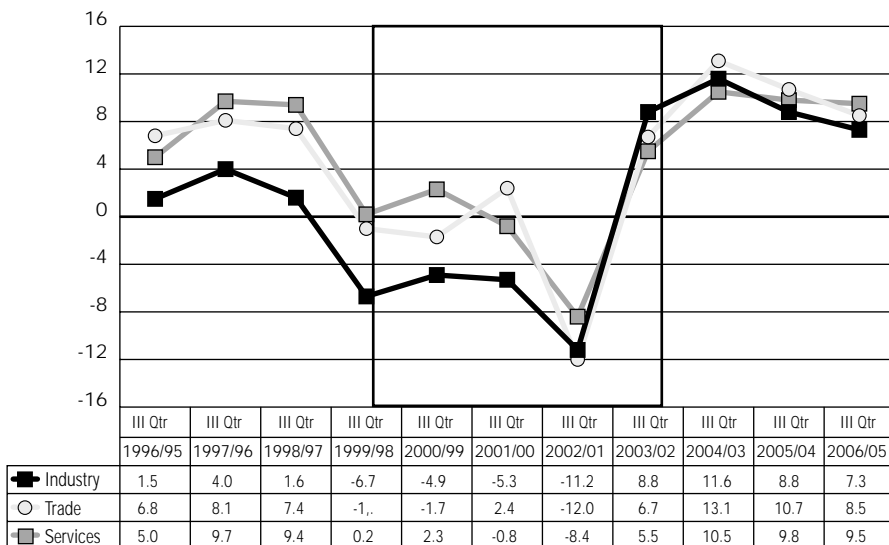
Source: Observatory of Employment and Enterprise Dynamics – DGEyEL – SSPTyEL – MTEySS based on national pensions data – SIJP

When one looks at the sectoral pattern of the recovery of employment, what stands out is the homogeneity across all branches of the economy, as a result of the new growth pattern which, led by the production of goods, induces the creation of multiple production chains upstream and downstream.

In this regard mention can also be made of two important results of this growth model: the “virtuous” performance in terms of both quantity and quality of employment. The unemployment rate which in May 2003 was 20.4 per cent fell to 8.7 per cent at the end of 2006. In absolute figures, this means that almost one million and a half unemployed found employment in the context of the creation of over three million jobs.

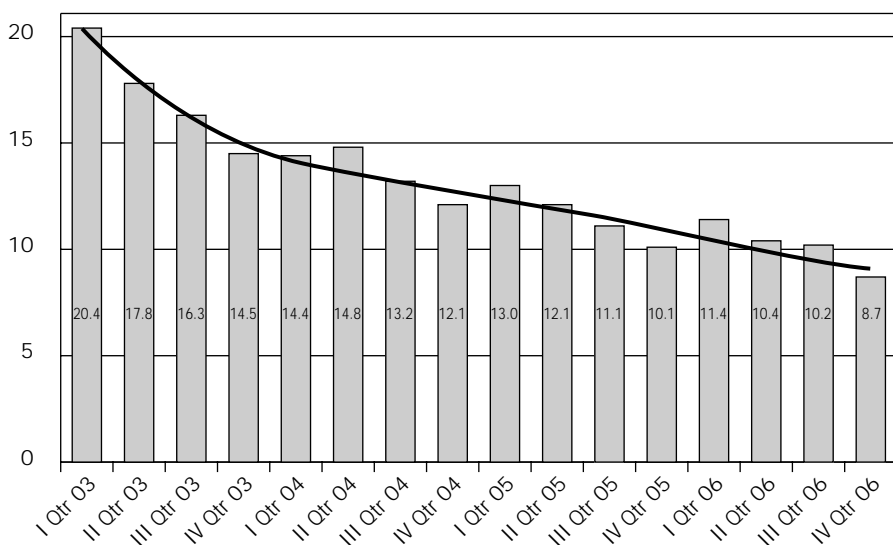
It should be emphasized that this good economic performance coincided with a significant recovery in labour productivity, which shows the sustainability of the improvements in incomes and economic growth, while at the same time profitability rose strongly. Furthermore, the business surplus in the overall economy, in terms of percentage variations in GDP, grew by 5.6 per cent in 2005 compared with 2001. Agriculture and industry experienced outstanding growth of 17 per cent and 14 per cent respectively over the same period.

Net employment growth by sector Variations between third quarters %



Source: Observatory of Employment and Enterprise Dynamics - DGEyEL - STPyEL - MTEySS based on SIJP

Trends in unemployment rate as % of the EAP



EAP: Economically Active Population. Source: continuous EPH survey, INDEC

Labour productivity in the Argentine economy, 1993-2005

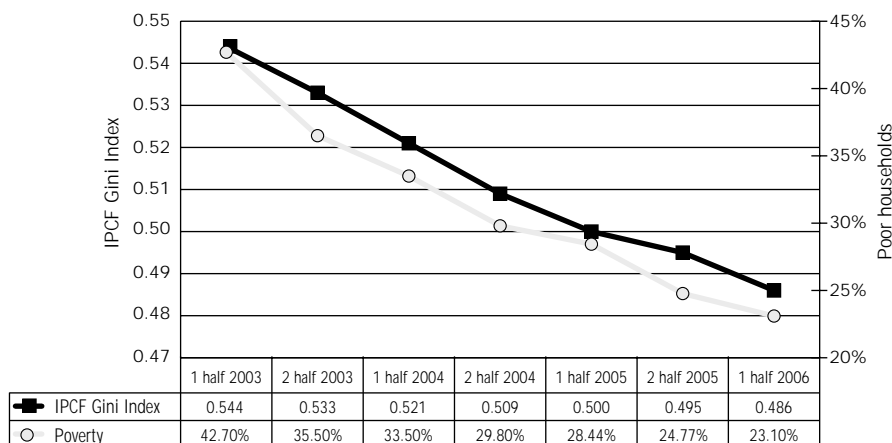


Source: Calculated by the authors, based upon National Accounts (DNCN)-INDEC data

Naturally, these trends have had a direct effect on poverty reduction and income distribution. Strong growth in employment and improvement in incomes concentrated in the lowest strata of the pyramid led to a sustained decline in poverty levels. It also impacted on households by increasing the number of employed earners. From the first half of 2003 to the second half of 2006, poverty declined from 42.7 per cent to 23.1 per cent of households. In 2006, 2.6 million people were taken out of poverty. The fact that almost 500,000 beneficiaries of the Unemployed Heads of Household Plan were able to enter the formal labour market, with the consequent effect on their incomes, also contributed to this result. It should be emphasized, however, that the poverty and extreme poverty rates in Argentina are still high. These pose a tall challenge which must be urgently addressed through appropriate policies.

We should emphasize here that to implement this macro-economic policy, the State also needed to regain its authority as “arbiter” of distributive disputes and conflicts, in a context where the aftermath of a long and profound crisis and the major economic recovery heightened political tensions and efforts by the various social actors to regain their previous positions. The new Government, elected in 2003 in the midst of a profound political crisis and with a weak electoral mandate, succeeded in rebuilding the power of the State on the basis of consensus. It was sup-

Poverty reduction and improved income distribution, 2003-2006



IPCF: Per capita family income. Source: continuous EPH survey, INDEC

ported in this by its success in building a sound and sustained financial position in the public sector, a novelty in Argentina's history. The social actors began to recognize the State's capacity to establish a bargaining agenda which would both achieve the objectives of economic growth and improvement of incomes distribution.

The fiscal surplus stemmed precisely from a tax policy which allowed the formulation of incomes policies for employed and unemployed workers. Resources were obtained by taxing the extraordinary profits obtained by exporters as a consequence of the increase in international prices and the high exchange rate, the strong growth in levels of activity and registered employment. In turn, the recovery of people's purchasing power stimulated the domestic economy, while prudent management of public spending ensured macro-economic sustainability.

Thanks to this surplus, the State was able to support one of the most far-reaching social programmes in Latin America (which ultimately reached as many as two million recipients), the Unemployed Heads of Household Plan, implemented from May 2002, at a cost of around 1 per cent of GDP, financed partly from taxation of primary exports. As pointed out by Frenkel, Damill and Maurizio (2007), the multiplier effects of this programme worked at the macro-economic level to achieve a more rapid and homogenous return to growth.

In addition, the process of actively renegotiating external debt conducted by the Government in the face of strong domestic and external criticisms and without the support of the International Monetary Fund, culminated successfully with a considerable reduction in the amount of debt (from 8 per cent to 2 per cent of GDP). This meant a considerable relief to the financial situation of the public sector and made it possible to lift the restrictions caused by debt payments on foreign currency earned through exports (interest payments on public and private debt in 2005 represented only 15 per cent of exports, compared with 45 per cent in 2001) (Gerchunoff, 2006:4), with the consequent expansion of the State's freedom to implement economic decisions.

Growing and attractive business opportunities in a context of high international liquidity stimulated the use of idle capacity and encouraged greater investment which led to an expansion of the productive potential. The investment rate reached a record level of 23.46 per cent of GDP in 2006, up from 11.96 per cent in 2002. Once a degree of economic stability had been restored, public works also took on an important role in growth and investment. The strength of economic growth was also reflected in the increase in the Central Bank reserves, which allowed early repayment of almost ten billion dollars of loans to the International Monetary Fund in early 2006. The level of reserves, after that disbursement, were recovered by the end of the same year and is now over 37,000 million dollars. In short, investment also played a special role. The contribution of industry and construction accounts for some 50 per cent of economic growth.

Employment has now taken on a central role in this process of economic growth. Since 2002, private consumption has contributed 58 per cent of growth in the level of activity. This good performance was based on the increase in wages due to more employment and real incomes (MECON, 2006). At the same time, the increase in employment was predominantly in the formal sector, with a consequent impact on the slow but steady decline of the informal sector and a positive impact on public finances.

In this regard, the process during these years differs from that which occurred in the most dynamic countries in the developing world. In an analysis of the so-called BRIC countries (Brazil, Russia, India and China), the OECD shows how despite considerable economic growth and employment in Brazil, China and India, over 50 per cent of total employment relates to the informal sector (in India it even reached 90 per cent) and continues to rise (OECD, 2007:5).

Labour policies: objectives and strategies

Analysis of the role of a ministry of labour and labour policies in this new macro-economic model requires a detailed examination of economic growth and the active policies implemented. Under the neo-liberal model, the labour portfolio had a more or less subsidiary role in macro-economic policy despite the rise in unemployment, in a context of labour flexibilization, unregistered work and the loss of quality jobs (Tomada, 2005). In consequence, the nineties contributed to a significant erosion of labour institutions.

In this new era, it was essential to restore the capacity both to formulate specific policies and articulate and coordinate them. The design and management of labour and employment policies in the broadest sense ceased to be a result of other variables and, based on the decision to put employment at the centre of economic and social policies, became a central pillar of the consolidation of the new growth model. In this context, the key institutions recovered their true essence, among them the strategic role of labour inspection is becoming again the cornerstone of an active policy of combating unregistered employment and protection of conditions of work.

Thus, in a framework of robust economic growth, labour policies have become a prime instrument for policy as a whole. This shows that the creation of more and better jobs and modern and balanced labour relations is not automatic and does not result solely from macro-economic policies. It needs selection, adoption and adaptation of strategies and measures which are not “given”, but which must be developed and adapted to the context in line with desired medium and long-term goals.

This involves the generation of areas of policy-coordination based on precise diagnostics and *ex-ante* appraisal, monitoring and *ex-post* evaluation of the impact on employment of the various macro-economic decisions and the way in which they interact with the core variables of economic growth, distribution of income and prevention of poverty and exclusion.

Thus there was a shift from a ministry of labour which dealt with basic social demands — a product of the crisis and people's lack of incomes — to one which promotes an approach to collective bargaining as a channel for managing industrial disputes, which is more consistent with a rapidly growing economy wherein the contest over wealth distri-

bution is a reflection of that very growth. However, given that it started from a very high level of unemployment at the beginning of the recovery period, one of the priorities that the State had to address was the development of an employment policy to promote education, training and coordination of supply and demand for labour, by creating consensus among the social actors, with emphasis on putting the policy into practice at local level.

Consequently, the current active management policies of the Ministry of Labour, Employment and Social Security are based on three pillars: one of rebuilding of the labour institutions (institutional pillar), another of incomes policy and lastly, employment policy.

Labour institutions

The abandonment by the State of some its exclusive functions in labour relations during the nineties left its most obvious mark in the insecurity and exclusion of vast sectors of the population. Clear signs of these were both the rise in unregistered employment, the proportion of the economically active population without current or future social protection, and the lack of institutional forums for the settlement of disputes.

One of the State's chief tasks in labour policy, then, was to restore lost institutional foundations by approving a new legal framework for labour relations, promoting collective bargaining, rebuilding the labour inspectorate. It was also to restore the State's ability to mediate in the industrial disputes characteristic of a growing economy.

The reorganization of labour, aimed at providing a set of legal and formal instruments compatible with current needs, not only short-term but strategic, was set out in Law No. 25,877, passed in 2004. This first law explicitly set out the promotion of decent work as a priority objective of government policies — a first in Latin America — and dismantled some of the most regressive labour market institutions permitted in the nineties:

- With regard to the duration of collective agreements, which had been restricted by the neo-liberal reforms, ultra-activity was restored, with respect to the prevalence of lower (company) level agreements over those at a higher (activity) level. The principle of succession of agreements and preservation of the most favourable conditions was restored.

- Law 25,877 established differential treatment for social security contributions for companies with up to 80 workers, to reflect the differences in economic performance compared with larger companies. This concerns a segment of the productive fabric which has a major impact on employment.
- This Law also expressly introduced, in the context of collective bargaining, the power of joint committees to intervene in the re-classification of jobs as a result of technological innovations and new forms of company organization. This aspect was considered central to avoid the possible emergence of restrictions which would make it difficult to improve productivity (Galín and Monza, 2004).

With this legal framework, more consistent with the needs of production but without neglecting labour protection, the promotion of collective bargaining became the best way of achieving better distribution of the wealth created in the new economic environment. The rising power of collective bargaining is currently reflected in 930 covenants and agreements approved in 2006. The growing coverage of workers in new or renewed agreements in this period¹⁴ (a total of 1,200,000 in 2004, 2,100,000 in 2005 and 4,200,000 in 2006) is also a product of the recovery of collective bargaining by sector which had collapsed during the nineties¹⁵.

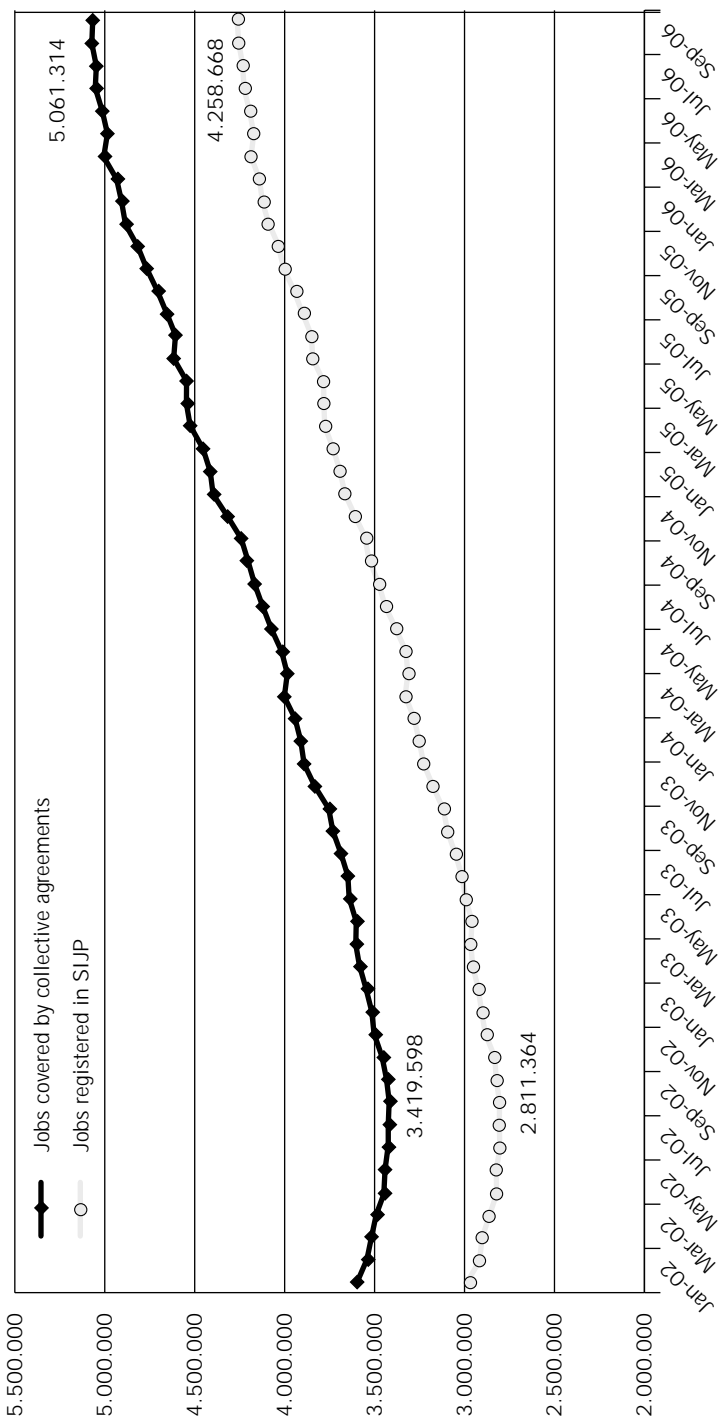
During the last decade, as a result of efforts to make employment and wages more flexible in the context of openness and indiscriminate trade liberalization, the Government had encouraged collective bargaining at company level, as a result of which wage agreements were far removed from average wages. Today, on the other hand, collective bargaining by sector is being encouraged, which expands the coverage of workers, without excluding other forums of dialogue such as at company level where even more favourable conditions can be obtained.¹⁶

¹⁴ Partly due to old agreements which had been in force since 1975 under "ultra-activity" provisions had been renegotiated.

¹⁵ In this way, wages under agreements, unlike those of the 90s, constituted a central reference for the average wage in the sector.

¹⁶ Indeed, despite the criticisms directed at Law 25,877 that it would cause the disappearance of company bargaining, almost 70% of the 900 agreements approved in 2006 are at that level. It should also be emphasized that this is the longest uninterrupted period of collective bargaining since its introduction in 1953, since previously the alternation of civil and military governments prevented its continuity. This allows regular exercise of the mechanisms of social dialogue between employers and workers (Ministry of Labour, Employment and Social Security, 2006:13).

Job trends recorded in the private sector and those included in collective agreements 2002-2006



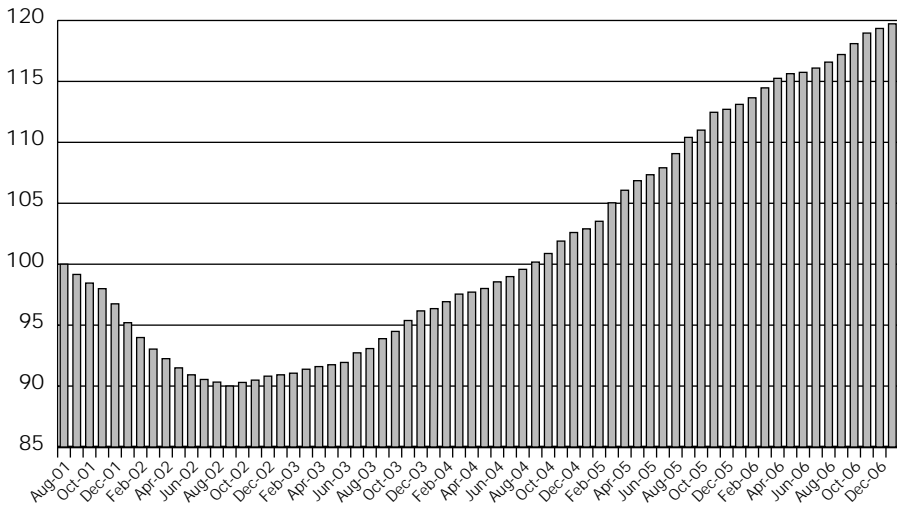
This rising trend in collective bargaining diverges from the predominant influences in international labour relations systems which are characterized by declining trade union influence and moves towards making labour more flexible (Palomino and Trajtemberg, 2007). Indeed, the OECD points out as one of the major phenomena of industrial relations in Europe the application of escape clauses which, under certain conditions, allow firms to negotiate longer working hours or pay wages lower than agreed in the sectoral agreement (OECD, 2006a: 158).

A third aspect of the rebuilding of institutions relates to the exercise of the powers of inspection relating to unregistered work. During the nineties, labour inspection had been virtually dismantled and the contract for an indefinite period de-legitimized by the various forms of contracting workers permitted under flexible labour laws, which made the task of a weakened inspectorate more difficult (Tokman, 2000:67) Both elements, enshrined in a policy of reducing labour costs and a more flexible workforce, resulted in a substantial increase in unregistered employment, as indicated above.

The new administration was faced with the dilemma of generating new jobs in an economy with 21 per cent unemployment, while preserving existing jobs — but for which the level of non-registration accounted for almost 50 per cent of workers. The scale of the problem was aggravated when considering international experience in this respect, which showed that there were very few cases where it had proved possible to achieve a substantial reduction in the level of “non-declaration” and that the effects of policies to overcome this are at best long-term (Campos and Galín, 2006).

The Ministry of Labour called for the labour inspectorate to be rebuilt and strengthened by raising its position within the institutional hierarchy, increasing its staff and resources significantly and launching the National Plan for the Regularization of Work (*Plan Nacional de Regularización del Trabajo — PNRT*). With an outstanding promotion campaign and a major inspection effort, the Plan seeks to reform patterns of behaviour and provoke cultural change on compliance with labour and pensions law. The goal of this policy, in a context of growth and bigger profits for companies, is to reduce the vulnerability of the sectors with the least bargaining power and to provide social protection and security both for workers and their families, now and in the future. PNRT statistics show that between 2004 and 2006, some 400,000 companies and

Employment trends – cumulative total (base 100 = Aug '01)



Source: Labour Indicators Survey (EIL), Ministry of Labour, Employment and Social Security

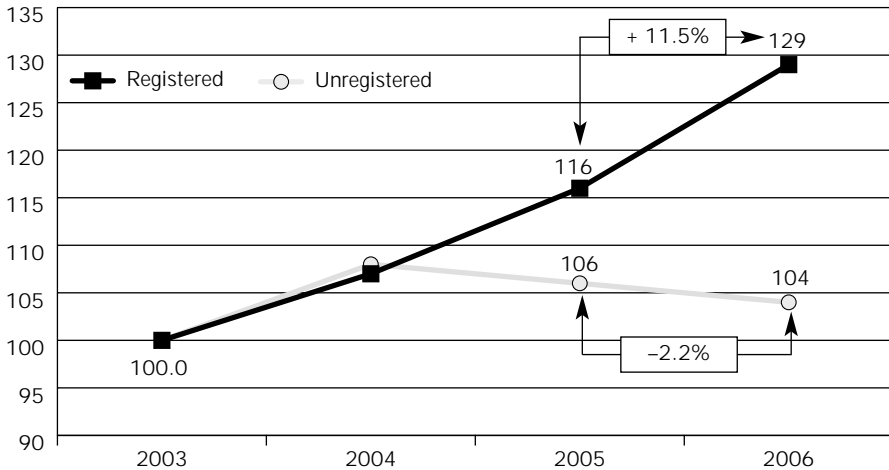
over one million workers were inspected and irregularities were found in almost 100,000 companies.

As can be seen from the following graph, employment in the formal sector has been growing without interruption and at an ever faster pace: between 2002 and 2003 it grew by 1.4 per cent, between 2003 and 2004 by 6.8 per cent, between 2004 and 2005 by 8.9 per cent and in the last year at a rate of 7.7 per cent, one of the highest recorded since 1995.

Further evidence of the new pattern of growth and the effect of the recovery of the labour inspectorate is that 89 per cent of jobs generated between 2003 and 2006 are registered jobs. This fact is of the utmost importance because it discredits the idea that the shift to informality is necessarily a one-way street.

Despite the fact that unregistered employment has declined by over 7 percentage points, from 49.7 per cent in 2003 to 42 per cent at the end of 2006, it is nevertheless still high, because these changes operate at the margin of a very high undeclared labour pool. One of its chief characteristics is its great diversity. The largest number of undeclared workers are concentrated in domestic service, followed by construction. Moreover, unregistered work also extends beyond informal economic

Trends in registered and unregistered wages, 2003/2006
Urban Total Base 100 = 2003



Source: SSPTy EL — DGEy EL, based on EPH (INDEC)

units. Labour inspection has revealed the presence of a very considerable percentage of unregistered work in formal companies.

Finally, cutting across the three pillars of labour policy — and a cornerstone for internal and external policy coordination — the State placed particular emphasis on the generation of information to support decision making. This applies to the public sector — in the design of policies, plans and programmes and the establishment of the economic and social objectives — but also to support the involvement of private agents in collective bargaining, avoiding the all-too familiar zero-sum games which shackle economic growth. On the basis that every solution to every problem requires in-depth knowledge, the will to act and to engage. The structure of the Ministry of Labour has been strengthened in the areas dedicated to analysis and monitoring of the different labour market variables to guide policy making in this area. It is these studies which underpin and guide the State's actions in this sphere, because the production, analysis and interpretation of information have a strategic place in management and decision making, while at the same time they are crucial in involving the concerns of the public.

Incomes policy

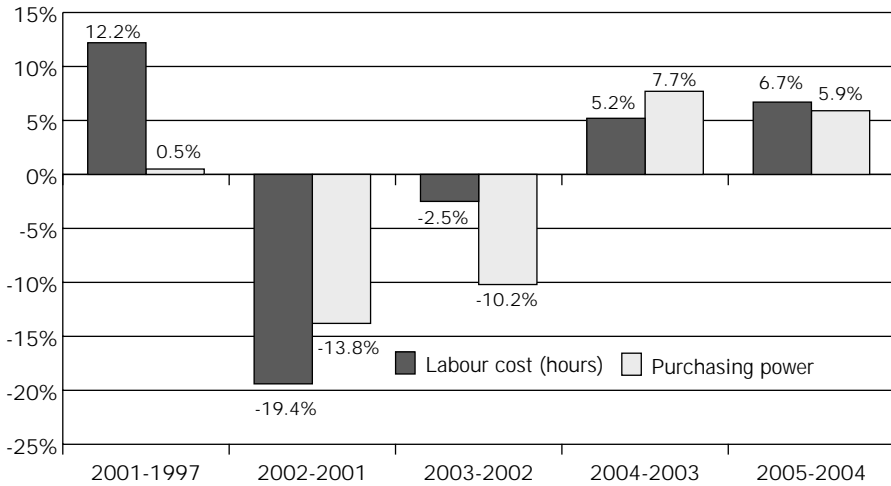
The growth cycle centred on the idea that more employment means more consumption, leading in turn to more investment, required the development of active incomes policies. Otherwise, with the high rates of unemployment and unregistered work, as well as the reduced bargaining power of workers, the fruits of economic growth would have been distributed very unfairly, thus hindering economic growth. This incomes policy was based on three instruments: the minimum wage, the encouragement of collective bargaining (which has already been discussed in the section on institutional instruments) and pensions policy. The latter involved an improvement in minimum pensions and an increase in coverage by providing access to the system for a considerable part of the population which had been excluded from it by the reforms of the 90s.

The wages and incomes policy for employed workers focussed initially on imposing increases in the fixed amount imposed by decree. In the early days of the economic recovery, this had the objective of improving the purchasing power of wage-earners on the lowest incomes most affected by the devaluation. Translating these amounts into bases of agreements, generated on the one hand a high level of bargaining activity and, on the other, impacted positively through emulation on those workers not covered by collective bargaining or not registered.

Wage policy was also heavily based on the recovery of the minimum living and adjustable wage (*salario mínimo, vital y móvil* — *SMVM*), the central institution of the labour market which had been abandoned in 1993, when it lost all its value as an economic benchmark. The adoption of this strategy on the role of the SMVM in relation to incomes policy did not pass without debate. The needs of workers, the ability of companies to pay and the demands of economic development were core elements of that debate. In the course of its history, the objectives of the SMVM were modified in relation to the economic context: to protect the lowest-paid workers in the 70s, to provide incomes in a context of high inflation and basic social benefits in the 80s, to eliminate “rigidities” in the 90s for which purpose it was weakened.

It is significant that the weakening of wage policy coincided with the period of greatest inequality. Orthodox theory maintains that the impact of the increase in the SMVM can be negative, given the increase in labour costs which discourages employers from hiring new workers. Out of context and from a perspective of partial equilibrium, this asser-

Labour cost and purchasing power of wages (hourly)



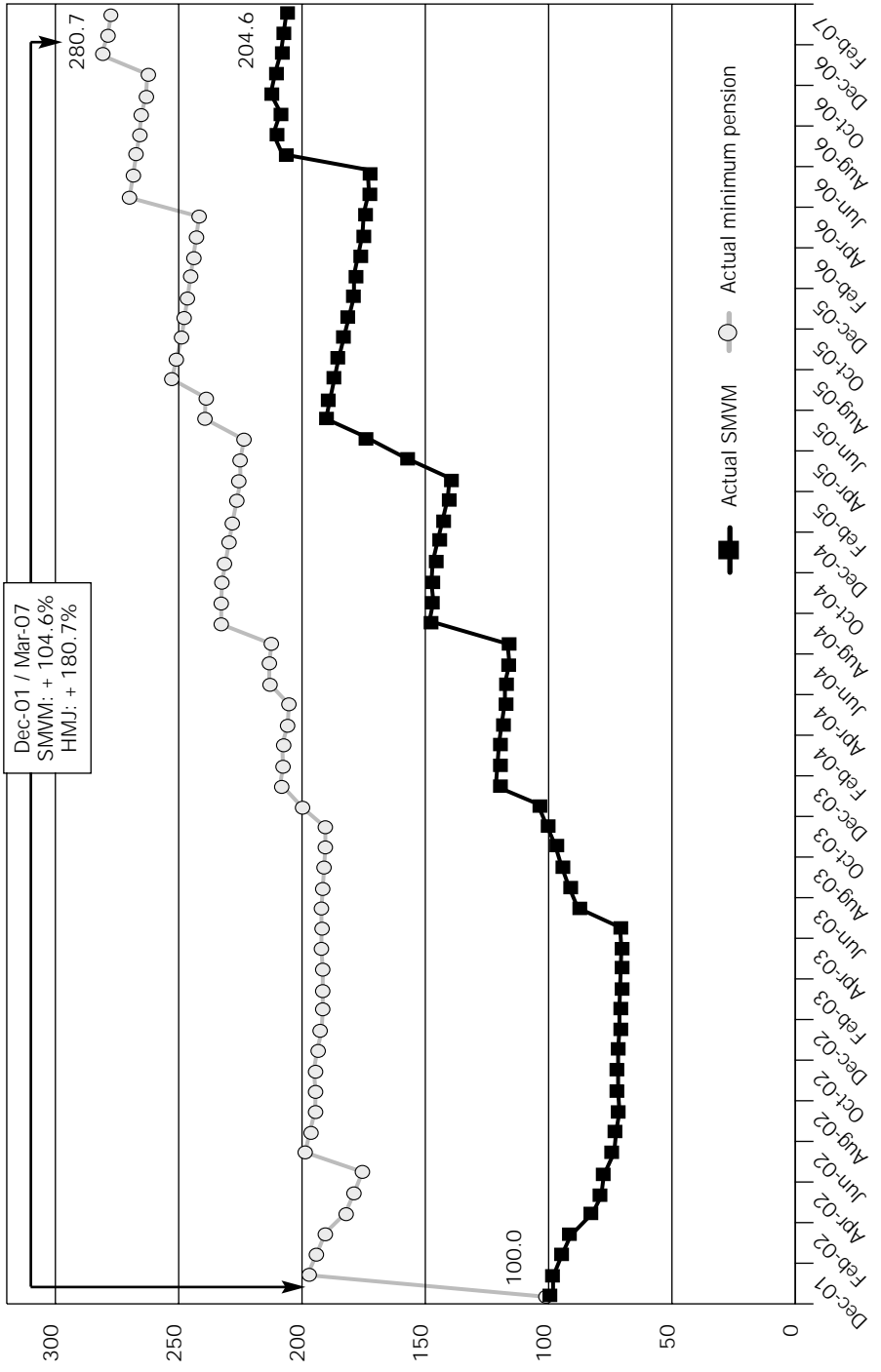
Source: Calculated by the authors, based on DNCN-INDEC data

tion may be true (Kostzer, 2006). Yet even if we exclude from the analysis the fall in relative labour costs, the strong economic recovery, the idle capacity of the capital stock at the end of the crisis, and/or the multiplier effect on domestic demand, it can be seen that increases in the SMVM — despite their magnitude — were not enough immediately to increase labour costs (see graph on the following page).

On the other hand, from a structural perspective, where evasion of other taxes leads to a need to generate expenditures not subject to registration, chiefly remuneration, the criticism was raised that unregistered workers lack the benefits of the SMVM and increases in the fixed amount. In other words, the policy of improving the minimum wage was questioned for not reaching those whom it was supposed to benefit, i.e. non-registered workers, or because it could have detrimental effects on employment generation and impact negatively on wage inequality.

After eleven years of inactivity, when the National Council for Employment and Productivity and the Minimum Living and Mobility Wage, a tripartite body, resumed its work in 2004, it was found possible to improve the purchasing power of the minimum wage and reach a value compatible with the needs of those families least protected in terms of income. It is worth highlighting that the SMVM received by workers rose by 300 per cent from 2003 to 2006, from \$200 to \$800. Its improve-

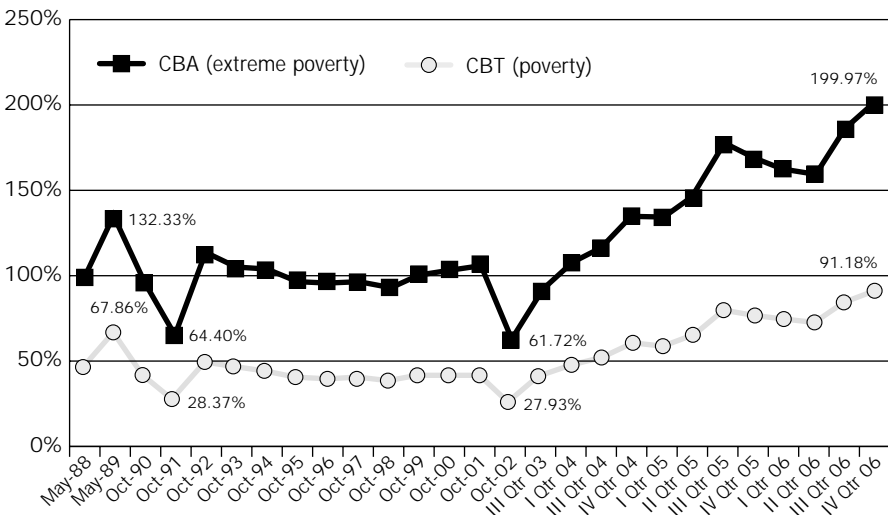
Trends in SMVM and Actual Minimum Pension (HMJ) – Deflated by CPI



ment in real terms was 105 per cent from 2001 to 2006. All of this was against a background of low inflation, macro-economic stability, a sharp fall in unemployment and the rise in registered employment. This increase meant that it rose from covering 37 per cent of the income necessary to rise above the poverty line in the nineties to 84 per cent in 2006.

Despite the objections that were raised, the SMVM did have a catalytic effect on remuneration in the unregistered economy, which between 2003 and the present day rose by an amount similar to that of workers declared under the social security system. Marshall (2006) shows that, although with a certain time-lag and partial application, increases in the minimum wage had a positive impact on movements in the lowest wages of both registered and unregistered workers. This finding is consistent with Saget (2006), who analyses the cases of Brazil, India, Indonesia and South Africa and states that the minimum wage has an impact on wages in the informal sector and suggests that this happens if the mechanism is simple, that is, if its existence and level are widely publicized among the population.

Coverage of the SMVM with respect to the basic food basket (CBA) and total basic basket (CBT) for a family of two adults and children (1988-2006)



With regard to the non-working population, in order to improve the situation of the adults most affected by the crisis, the Government gradually restored retirement and other pensions of lower income value.

Just as in the case of the SMVM, the increase in the minimum pension (*haber mínimo jubilatorio* — *HMJ*) also became a strategic resource in improving the quality of life of those who have the least bargaining power. The HMJ rose from \$220 in December 2003 to \$470 in June 2006, a cumulative increase of 114 per cent. In addition, a series of legislative measures adopted on the principle of maximum inclusion by the social security institutions promoted recognition of a social debt contracted by the State with those citizens who for one reason or another could not make pension provision, either because they were in unregistered work or because of the successive economic crises undergone by the country. Thus, almost 800,000 people aged over 60 years were able to start receiving pensions under a system of early unemployment allowances. This meant an increase of 15 per cent in the pensions coverage for those aged over 60 years.

In the same vein, a bill is currently before the National Congress whereby one million agricultural workers, in many cases seasonal or casual workers, will come into the state pensions system so as to guarantee their future pension. This measure, like the previous one, is also aimed at further expanding social security policy, by allowing the inclusion of retired workers who, because they could not fulfil certain requirements or did not work regularly, could not previously be included in the social security system.

Finally, mention should be made of the promulgation of a new pensions reform which introduced the possibility of workers being able to move freely from the public to the private pensions system and vice versa. This change, combined with better regulation of the commissions charged by pension fund managers, allows the possibility of choice, while the public system is revitalized and returns to the principles of solidarity between generations which had been lost with the reforms of the nineties. The latter promoted individualization of the system, the objective being to improve the relationship between costs and benefits and thereby to increase coverage. It should be noted that this aim was not achieved and private sector coverage declined.

Employment policy

Within the objective of strengthening employment as an instrument for reinforcing citizenship, it should be pointed out that the Unemployed Heads of Household Plan was maintained and reformulated. It constituted a transfer of incomes in return for work which promoted con-

sumption during the first stages of economic recovery in the regions most hit by unemployment and lack of opportunities. As 500,000 of its 2,000,000 million beneficiaries were being incorporated in the formal labour market and a further 500,000 fell out for various reasons (children reaching adulthood, people transferring to other plans, etc.) the Heads of Household Plan was redesigned in a way that differentiates the needs of households with the largest number of dependents from those of individuals who need to improve their skills to obtain a quality job. Thus, for the sector of previously “inactive” women¹⁷, considered to be in a situation of social and economic vulnerability, a “Families for Social Inclusion” programme was designed in the Ministry of Social Development, while for the unemployed with difficulties in obtaining formal employment, a Training and Employment Insurance Scheme was implemented in the Ministry of Labour, Employment and Social Security.

Prime among the series of active policies generally implemented by States are employment agencies and employment and vocational training services. In Europe, in the framework of the newly established “mutual obligations” of the State to provide adequate and efficient employment services and of individuals to strive to improve their employability at the risk of having their unemployment benefits cut or reduced, re-employment services have been at the core of this system of rights and obligations (OECD, 2006b). In the developed countries, they also seek to be a tool to match supply and demand for labour in various fields, especially in those strata of work and workers not covered by traditional job-seeking systems. This is complemented by education and vocational training programmes which help to meet the requirements of the new productive profile, based more on specific technical qualifications, such as skills training.

Just like unemployment insurance, of limited duration and with relatively low benefits, employment services are an institution which in Argentina has traditionally extended little beyond the public sector. In this respect, current government policy is different from previous development models, both the pre-1976 Welfare State and the market oriented model which replaced it. Thus, in October 2003, the Integrated Employment Promotion Plan “MORE AND BETTER JOBS” was launched, promoting entry into quality jobs and training of unemployed workers.

¹⁷ Monza and Giacometto maintain, in an analysis of the beneficiaries of the Unemployed Heads of Household Plan, that a considerable proportion were previously inactive women (Monza, Giacometto, 2003).

An essential part of the Plan's strategy, the current "Training and Employment Insurance", is supported by the employment office network which has 145 offices opened in 22 of the 24 provinces. It seeks to revive and use local dynamics and harness the strengths of the specific locality concerned. These are important, albeit incipient, steps in developing a system of employment services and agencies to meet a growing demand within a reasonable time. Consolidating this system will undoubtedly require initially a constant effort of institutional learning to tackle the difficulties inherent in the transition from an eroded labour market to an inclusive occupational structure.

Another instrument of employment policy is the so-called Sectoral Skills Agreement, an integrated set of actions which the actors in a given economic sector undertake with financial and technical support from the Ministry of Labour and other State authorities, to address problems related to skills, improving productivity and competitiveness, and expanding opportunities and the quality of employment.

Finally, the last principal component of these policies is the so-called Local Employment Promotion Agreement, a framework for the analysis of the strengths and weaknesses in the productive dynamics and population of a region, with a view to generating Local Strategic Plans to increase employment and work opportunities at the local level.

The agenda of unresolved issues

The set of policies presented here shows a State which is more active in economic and social development. Its interventions in employment, incomes and institutional strengthening of social dialogue, combined with greater articulation and integration of economic and social policies and major improvements in macro-economic policy and growth, indicate a new departure from the experience of the last three decades. No less important is the revival of the State's authority as an arbiter of disputes between the social actors and guarantor of the rules of coexistence.

Nevertheless, this new configuration of public policies does not strictly justify talking of a "new" model of economic and labour policy. As has been observed, the trend over a short period of time has been favourable in various ways but the transition from the crisis is not yet complete.

There is a series of questions which, in the short period since the end of the crisis, the State has not yet begun to address and still oscillates between *laissez-faire*, interventionism or regulation, depending on the subject and the economic situation.

One of the biggest obstacles concerns the high and persistent level of informal work in the region, which cannot be solved by inspection alone or by imagining that flexibility and deregulation are going to facilitate the inclusion of such low productivity sectors in the formal sector. The informal economy — where most poverty is concentrated — is also the result of unsophisticated productive structures, the poor circulation of knowledge and learning, and a pattern of formal sector modernization based on incremental innovations and rationalization rather than one based on increasing endogenous technological capacities (ECLAC, 2004). Although recent developments are encouraging (since a considerable percentage of jobs generated in the period 2003-2006 are quality, registered jobs), there is still a high level of unregistered employment (42 per cent of wage-earners), which constitutes an enormous obstacle to improving incomes distribution and eliminating poverty. This sector, dominated by low productivity jobs, has a complex structure, combining the effects of the erosion of the labour market during the 90s with more longstanding processes linked to structural weakness of various kinds — with public infrastructure and services deficits prominent among them.

At present, there is some uncertainty as to the sustainability of growth in the medium term, as well as supply constraints in some productive activities, the solution to which requires the removal of structural obstacles. Although the investment rate has recovered and surpassed historic levels, a considerable part of that is linked to the construction sector and doubts are emerging as to its capacity to expand output to meet growing demand. After a long recession and a deep depression, these data must be monitored in detail to avoid short-term bottlenecks which generate inflationary pressures.

In the long term, the productive specialization model still remains to be defined, between primary commodity exports or making headway in developing endogenous capacities to increase the added value of products. This is a “hard” structural question, since it implies the need to restructure the productive system into more complex sectors with more intensive use of technology. Defining this is more than relevant, since the choice between relying on income derived from abundant natural resources or from knowledge relates not only to the development model,

but most importantly to all its possibilities for social inclusion (Cimoli *et al.*, 2006).

In this regard, the debate has not yet even begun. Undoubtedly defining a sustainable economic development strategy in the future is not just the responsibility of the State, but must take place within the framework of a broad dialogue with all sectors of society. But it is the State that must set the agenda, otherwise it will be market forces that will decide which direction the economy takes.

Nevertheless, the State has already taken a few steps which show its concern with the medium and long term: tripling of the education budget, a significant increase in investment in science and technology and a strong allocation of resources to improve employability are the first indications.

Another pending question relates to the institutions needed to give sustainability and permanence to development policies. This means not only the legal and regulatory framework, but organizational bodies with better linkages between the public and private, regulation and promotion, between assistance and social security, as well as training and development and appropriation of technologies, which are still not fully on the agenda. This extends to the articulation between economic and social policies, which is currently successful but which depends on a considerable amount of political will. It still needs to be institutionalized in order to ensure that this integrated vision of economic and labour policy endures over time.

Conclusions

Once again, Latin America is at a crossroads. It is true that while the change in the climate of ideas is general in the southern part of the continent, the strategies adopted by each country are not the same. Broadly, they present what we can characterize as a more inward-looking view, directed towards civil society, the people, where the social deficit is more palpable and explicit and, along with efforts to reclaim national identities, the “new” governments have shown much greater concern for social protection. Quality employment acts as a convergent value, as shown in the Declaration of the Americas Summit (2005) although the macro-economic policy strategies are very different. Social segmentation and inequality of incomes in Latin America have grown enormously in

recent years, which is why it will not be easy in the present context to change course rapidly.

The analysis of the case of Argentina set out in this study shows a change of direction in economic and labour policy, without as yet, profiling itself as a new paradigm (at least in any precise way), with clear strategies and goals, or some definition of the pattern of productive specialization in the future. In any case, it seems evident that this is not a simple task, above all because the current global economy seems to challenge the most basic assumptions. The improvement in the terms of trade experienced by commodity-producing countries, which does not seem likely to reverse in the near future, have led even Paul Samuelson to state that never in his lifetime had he seen a combination of factors such as the current production of high-tech goods with cheap labour that causes their price to fall in the international market (Gerchunoff, 2006:4).

The central question which motivated our analysis, reflected in the debate on the European economic and social model with which this article began, is whether we are witnessing a new economic and labour strategy which seeks to revive the type of society which, with greater internal equilibrium and equity, Argentina possessed some decades ago, based on employment and upward social mobility.

An initial reply to this question is that it is still too early to say. There is significant integration of economic and labour policies, in which it is not a matter of “trickle down” or even just a question of macro-economic fundamentals, since heterogeneous strategies have been combined at different levels, enabling some return to inclusion and fairness, in a still on-going process. However, to be able to speak of a “model” of economic growth accompanied by a revival of social protection in an open economy, this trend must be sustained in the future over a reasonable time.

The sustainability of this model in the case of Argentina would seem possible in the short term since for the first time the three basic “economic gaps” have been filled. There is currently a trade surplus, domestic saving sufficient to cover immediate investment needs, and a tax sector which is being managed prudently generating surpluses for future anti-cyclical use. Although this alone is no guarantee of success, it does at least reverse some of the determining factors of the “stop/go” cycle of import substituting industrialization or the dependency on (almost an addiction to) the volatile external capital flows of the 90s. A considerable part of the sustainability of this model will be linked to the State’s capac-

ity to maintain the high real exchange rate and fine tune monetary policy and capital flows. Krugman (1987) points out the importance of a competitive real exchange rate and macro-economic stability as factors that may have a lasting effect on the relative productivity and specialization of an economy. Exporting productive sectors can gain experience, improve in specialization and produce at decreasing costs (*learning by doing*). Likewise, Agosin and Tussie (1993) state that the majority of countries which achieved sustained export growth maintained exchange rates which were attractive to their exporters. These exchange rates also tended to remain stable, allowing producers of tradable goods to invest for the long term (ECLAC, 2006).

The new pattern of growth is to a large extent based on the manufacturing sector, with its upstream and downstream chains, increased investment by medium-sized national companies, and the construction sector, with a strong role played by public works as a way of creating and improving infrastructure nationally. Both sectors are important creators of employment, generally of good quality in the case of manufacturing, although high levels of imports persist in many activities, an equation which it may perhaps be necessary to reverse to consolidate this incipient model and allow the structural change to which we refer.

Despite the sustained growth of the last years, it is still not clear what form income distribution will take in the coming years, not only the personal but also the functional distribution, and how this will influence savings behaviour in the long term. Up to now, incomes distribution has been somewhat volatile due to the initial conditions and the form of bargaining and the pressure of incomes in a context of high growth. Initially, it was the increase in company profitability which predominated (high dollar, low wages), but today through wage increases, the labour sector is partially recovering what it lost initially from inflation, while its contribution to increased productivity is a matter of dispute.

In labour matters, specifically, one must also recognize the difficulties presented by a highly regulated system of labour relations with a clearly law-based origin. It was a model which, before the import substitution period, was of an “instituted” character (Catalano and Novick, 1996), changing in the decade of the 90s to what Ermida Uriarte (1997) called “negotiated flexibility” and from there to a great variety of processes, including revival of collective bargaining in determining wages and the distributive effort to define a new model of labour relations. As

Goldín (2006) points out, “in the framework of new productive strategies, it will be necessary to rethink legislation, practices and institutions with the object of conceiving them less as old-fashioned declamatory statements and much more as a commitment to their effective application, efficiency in achieving their ends and revival of its safeguarding capacity. The full application of social rights is an essential precondition for the harmonious development of industrial relations and not the antithesis. Social equity and productive efficiency, it bears repeating, are inseparable values in a programme for progress”.

In this traditional logic of the pendulum, it is hard to find a neutral balance which promotes equity, not only in the current climate but also in the long term. It is a challenge for both the State and the other actors: in practice, the interlocutors do not recognize each other and, moreover, new actors emerge with and among whom it is necessary to rebuild relations of trust and recognition, establish new and clear rules of the game and know that they will be respected. This is still complex and difficult to achieve.

The emerging traits of Argentina's new labour policy suggest initiatives that have more in common with efforts aimed at reviving strong social protection characteristic of the Welfare State, rather than schemes such as the United States *workfare* or the Active Social State analysed by Boyer for Europe. In Argentina, there are few — albeit powerful — proponents of more flexible labour relations presented as necessary to compete with other nations, and who argue that growth per se is sufficient to ensure social development.

On the contrary, the State's concern is focussed on raising the level of protection to ensure that growth is sustainable and to improve equity and income distribution. The policies implemented — like those of active and passive incomes, expansion of pensions cover and review of pensions reform, a protective system of labour relations with emphasis on collective bargaining and other measures under discussion¹⁸ — suggest a clear direction: considerably broadened and strong social protection headed by an “active” State.

Is this perhaps an example of a strategy that stands in sharp contrast to the trend followed by the world's major economies? The Latin-American experience, which Argentina shares with its neighbours, has shown

¹⁸ Such as the extension of unemployment insurance coverage to all those who can show they were dismissed from an unregistered job, as stipulated in a bill submitted by a deputy to the National Congress.

that the adaptation of the models has been based on countries' particular political, economic and social characteristics. Likewise, it is possible to suppose that the model that seems to be emerging today is suited to the development needs and possibilities of the region, which is at a very different stage compared with the industrialized nations. The opportunities for business and economic growth seem "unlimited", due to the previous low utilization of its human capital and demographic characteristics which still distinguish our countries from industrial ones. There is perhaps a "window of opportunity" (Chakiel, 2004:85) for a re-entry into a global economy where the only certainty is uncertainty.

But for such an entry to become reality, another difficulty in addition to those already mentioned is the effect of "imaginary factors", diverse representations by the social actors, whether traditional (chambers, companies, trade unions) or new (social organizations, organizations of unemployed, social movements, etc). With important differences, it is similar to the European debate which we discussed at the beginning of this article. Some actors — in enterprises and economic and/or financial corporations, the big winners of the 90s — continue to defend the laws of the free market and the vision of a minimalist State, albeit one which ensures a disciplined labour force, large profit margins and freedom of financial movements at national and international level, as well as deregulation of labour and low costs. Other actors, including trade unions, envisage a return to an omnipresent State, regulating, intervening and also acting as employer of last resort. Without a consensus among the social actors on an appropriate economic and social development model and role of the State, it is unlikely that the configurations of an integrated society can be restored.

In this respect, we can say that the Government and civil society must find alternative and innovative ways forward, since in a global economy such as the present one, no return to the past is possible, let alone desirable. It is a matter of trying to build, innovate and consolidate processes which lead towards productive structures closer to the technological frontier and an emerging knowledge-based economy which allows progress towards competitive, more productive and better quality and secure jobs. This will provide us with a more inclusive and equitable society in a global context in which it is a matter of urgency to reverse the trends which lead to "downward" equalization.

Finally, if any lesson can be drawn from Argentina's recent evolution, it is that after constituting in the 90s a true prototype of the neo-

liberal model, the collapse of that model opened the way to a new pattern of economic growth. In an original way, this new pattern reconciles the conditioning factors of the new globalization with an economic and labour policy which promotes productive activities and quality employment. What is needed now is to make this economic growth model sustainable in the long term.

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Macroeconomic policy changes in Argentina at the turn of the century¹

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Executive summary

This paper presents and analyzes the macroeconomic policies implemented in Argentina in the nineties and in the period that followed the collapse of the Convertibility regime in late 2001. It also examines the connections between macroeconomic policies and the evolution and performance of labour-market variables and some indicators of income distribution and social conditions.

Since 1991, the Convertibility Law transformed the central bank into a currency board. The legal constraints on the central bank's ability to autonomously manage the monetary base left domestic liquidity and credit almost fully dependent on the evolution of the stock of foreign reserves, that is, on the balance of payments results. The macroeconomic setting of the nineties also combined trade opening with an appreciated exchange rate that resulted in a chronic trade balance deficit and a rising current account deficit. To sustain any positive rate of growth the economy necessitated substantial and increasing external capital inflows.

In a first phase of significant financial inflows, the economy expanded while its vulnerability to foreign shocks increased. The volatility of the international financial conditions confronted by the country was mechanically transmitted to both domestic activity and employment levels.

The unfavourable turn in the external financial situation which took place in 1997-1998, after the Southeast Asian and Russian crises, found Argentina with a high and growing current account deficit, an over-appreciated currency, and an evident shortage of policy instruments for dealing with this set of problems, because of the rigidity of the macroeconomic scheme adopted. The country risk premium increased and the economy stagnated. The 1999 Brazilian crisis was a significant addition to the series of negative shocks. By late 2000 a run against the peso started. It kept going intermittently throughout 2001 bringing the macroeconomic regime to its final crisis.

It is, at first sight, striking that the crisis and the massive default took place in a country that for a long time was considered an example of the Washington Consensus success. Almost until the end of the nineties, the IMF and most of the financial market's analysts considered the Argentinean experience as one of the success stories of macroeconomic policy and structural reforms in the financial globalization context. The Argentinean currency board regime was usually mentioned as an example of a

feasible “corner solution” for the exchange rate policy in an emerging market country.

An employment cycle was clearly observable in Argentina under convertibility. The aggregate employment rate tended to rise in the early nineties, subsequently going down steadily and standing at the end of 1996 well below the 1990 employment rate. Privatizations and fiscal adjustment in the provinces had a bearing on this behaviour, but the heaviest negative impact came from the restructuring and concentration of activities in the production of tradable goods caused by trade openness and exchange-rate appreciation.

The end of the macroeconomic regime of the nineties involved a series of traumatic events, including a huge depression of economic activity, a financial crisis, the partial default of the public debt, a strong devaluation of the peso and a considerable worsening of social conditions in 2001-2002.

However, since the second quarter of 2002, GDP has been growing at an impressive rate, between 8 and 9 per cent yearly. The paper shows that domestic factors had the main bearing in explaining the 2002 turning point. The recovery was actually bolstered by the shift in the relative prices caused by the devaluation and also by an adequate set of policies that, despite some flaws and ambiguities, nevertheless succeeded in stabilizing the FX market and domestic prices and recuperating the basic macroeconomic equilibria. Among the many factors behind this recovery, the launching in the second semester of 2002 of an unemployment subsidy programme (the so-called ‘Plan Jefas y Jefes de Hogar Desocupados’) should be underlined. It provided income to about 1.8 million of beneficiaries. An improvement in nominal wages was associated with a rapid fall in unemployment, and was also helped by an official policy consisting in several lump-sum rises in private sector wages determined by decree during 2002-2004.

There is significant evidence showing that a depreciated or competitive real exchange rate tends to increase the labour intensity of output, given a certain activity level or growth rate. So, the employment recuperation stimulated private consumption through two effects: on the one hand, by increasing the number of wage earners and, on the other, by contributing to the rise in real wages.

The economic recovery has among its main pillars a strong adjustment in the balance of payments current account results and also in the

fiscal accounts. An utmost step to fiscal consolidation after the crisis was the partial restructuring of the public debt. It involved a significant haircut in the nominal amount of the public financial liabilities, as well as an important reduction in interest rates and a considerable extension of average maturity. The government also captured part of the income effect of the peso devaluation through export taxes that made an important contribution to fiscal consolidation.

The paper examines in detail the monetary and exchange rate policies of the post-crisis period, paying also attention to the relationship between the IMF and Argentina after the devaluation and the default. It is argued that the IMF's support was absent precisely when it would have been more necessary: in the period after the devaluation, when efforts to stabilize the economy were at the centre of the economic policy. Although the new management's criticisms regarding the support given by the IMF to the convertibility regime were justified, this did not provide a reason for not supporting the post-devaluation stabilization efforts. On the contrary, the self-criticism of the IMF implies an acknowledgement of its own part of the responsibility for the crisis. Therefore, the organization should have been even more committed to the stabilization attempts. Beyond that, the Argentine authorities permanently had to confront the staff in order to defend their diagnosis and preserve their degrees of freedom.

At the beginning of 2002, for instance, the IMF exerted pressure asking for a free floating of the peso. When the measure demanded by the IMF was implemented, it was followed by an abrupt rise in the price of the dollar, as it was clearly expectable, and a fast acceleration of inflation. The country got nothing in exchange for that "prior action." Soon after, a new stabilization programme was implemented that preserved the flotation but introduced interventions in the exchange market, and reinforced some exchange controls aiming at stabilizing the exchange rate. This policy also faced the opposition of the IMF, though in this situation the demands of the institution were not satisfied. The interventions and the control measures that were introduced, in spite of the opposition of the Fund's staff, turned out to be crucial for the exchange rate and the inflation stabilization. It is clear that had the economic policy followed the orientation that the IMF wanted, the evolution of the economy would have been more in line with what the IMF expected. The implementation of the measures promoted by the IMF would have transformed its implicit diagnosis in a self-fulfilling prophecy. Finally, by the

end of 2006 the government decided to pay back ahead of schedule the whole outstanding debt owed to the IMF, or close to 10 billion US dollars.

By mid 2002, the rise in the price of international currency could be stopped and an appreciation period ensued. The nominal and real appreciation process ended around mid-2003. This was mainly the result of a deliberate policy decision. The preservation of a stable and competitive real exchange rate (SCRER) was gaining relevance in the official policy orientation. The government started to make explicit reference to the importance of preserving a SCRER in the official economic strategy. Although the announcements did not identify a specific policy target, the government — meaning both the central bank and the Treasury- operations in the FX market actually controlled the price of the dollar in a range between \$ 2.8 and \$ 3.10. This exchange rate policy has been conducted together with a monetary policy based on quantitative monetary targets, which started in 2003. In 2003 the central bank started to face more openly the situation of dealing with two 'potential' conflicting objectives: the preservation of a competitive exchange rate by intervening in the FX market and at the same time the attainment of the strict monetary expansion targets announced in the monetary programme. In order to soften the appreciation pressures in the FX market and thus alleviate the central bank's intervention needs, controls on the capital account were introduced in June 2005.

In the recovery period, employment and wages also recovered significantly. The full-time employment rate recuperated all the fall experienced during the Convertibility regime period reaching similar levels to the early eighties. On the other hand, the current total employment rate (without social plans) reached the highest in the available series.

There has also been a reduction in the wage gap between the extremes of the distribution that has contributed to the reduction in inequality among workers. One of the factors that have contributed to this process has been the significant incomes policy implemented by the National Government since mid-2002 through lump-sum rises and increments in the minimum wage.

In effect, the Gini index of income from main occupation fell 8 per cent between the first semester of 2003 and the first semester of 2006 passing from 0.472 to 0.435. However, despite the reversal in the trend towards greater inequality, the concentration of income is still high due to the high level of income inequality prior to the change of regime.

Introduction

This paper presents and analyzes the macroeconomic policies implemented in Argentina in the nineties and in the period that followed the collapse of the Convertibility regime in 2001-2002; it also examines the connections between macroeconomic policies and the evolution and performance of labour-market variables and some indicators of income distribution and social conditions.

The paper pays particular attention to the role of the IMF, both in its supportive stance regarding the macroeconomic orientation of the country in the nineties and its almost systematic antagonism to the main aspects of the economic policies pursued by the Argentinean governments of the post-crisis period. These policies aimed at stopping the conflicting trends characteristic of the crisis, bringing the economy out of a deep depression and overcoming a very difficult social and political situation. The country had to face these difficulties in isolation, confronting not only the huge difficulties of the internal circumstances but a permanent conflict with the IMF to preserve room for manoeuvre for its policy decisions. Not even success would warrant a more collaborative attitude from the authorities of the Fund, and the Argentine government finally decided to pay back ahead of schedule the entire debt with the institution at the beginning of 2006.

The paper is divided into four sections. The first section analyzes the Convertibility regime period, from its implementation to the crisis. The second section is focused on the evolution of the labour market variables in the same period. The third section examines the macroeconomic policies and performance in the post-crisis period, and the fourth one is devoted to the labour market in the same stage as well as to a description of the evolution of some indicators of the evolution of the social situation.

1. The convertibility regime and the Argentine economy in the nineties³

In March 1991, the Convertibility Law entered into force. It established fixed peso-dollar parity and stipulated that the central bank must back 100 percent of the monetary base with foreign reserves. It also

³ For an extensive treatment of the macroeconomic regime, labour market, and income distribution evolution in the nineties see Damill, Frenkel and Maurizio (2002 and 2003) and Damill and Frenkel (2006).

validated domestic contracts in foreign currencies. By September 1992 a new Central Bank Charter established its autonomy and also set narrow margins to its possibilities of purchasing public bonds and lending to commercial banks.

This novel monetary arrangement was the pillar of a broader stabilization programme intended to take the economy away from the high inflation regime prevailing since mid-seventies⁴, which had led to two brief hyperinflationary episodes in 1989 and 1990. The programme included an almost complete liberalization of trade flows⁵ and a full deregulation of the capital account of the balance of payments. It was jointly applied with a deep and extensive process of market-friendly reforms, targeting the privatization of most state-owned enterprises⁶.

In practice, the Convertibility Law transformed the central bank into a currency board. This feature was essential in the new macroeconomic regime. In effect, the legal constraints on the central bank's ability to autonomously manage the monetary base left domestic liquidity and credit almost fully dependent on the balance of payments results. Central bank's reserve accumulation led to an endogenous expansion of the monetary base and the banking system credits and fostered domestic demand. On the other hand, international reserves contractions automatically resulted in reductions of the monetary base and credit, inducing recession.

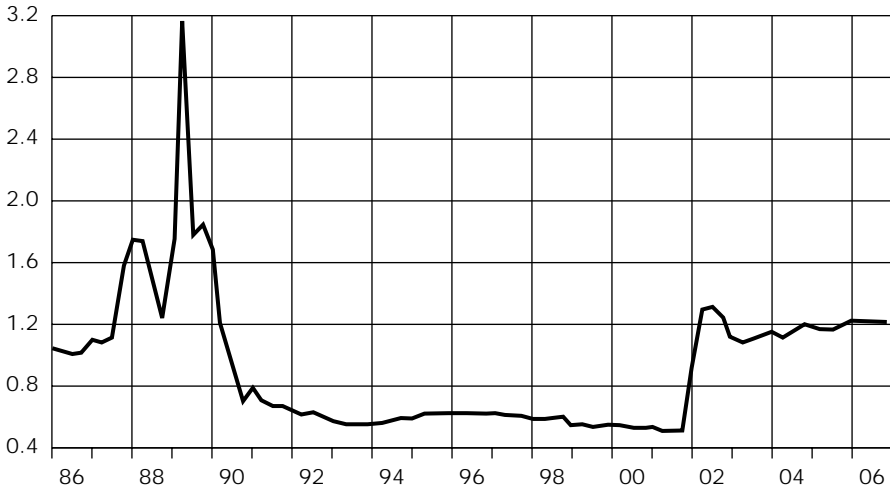
Besides the above mentioned legal and policy framework, there are two other aspects that should be underlined as crucial characteristics of the economic setting in the nineties. Firstly, the real exchange rate was already appreciated when the nominal exchange rate was pegged to the dollar in March 1991 and this appreciated level lasted throughout the nineties (see Graph 1). There was an important increment in manufacturing sector labour productivity in the decade, but the average unit

⁴ On the high inflation regime see Frenkel (1990).

⁵ A gradual trade liberalization programme had already begun in 1988. However, in the nineties, the opening process was accelerated. Average import tariffs were reduced from 26.5 per cent in October 1989 to 9.7 per cent in April 1991. In addition, specific duties were eliminated, as were quantitative restrictions on imports. Only special tariffs for a reduced group of articles (including motor vehicles and electronics) and restrictions for 25 tariff items were maintained.

⁶ Privatizations started in 1990 with the transfer of the telephone company and the national airlines. By late 1994, the major part of the state-owned firms producing goods and services had been sold, including the most important ones: the oil company (YPF) and the producers and distributors of electric power. In some cases (oil fields, railways, ports, highways, waterworks and sewage, and television channels and radio stations), the government resorted to the privatization of management.

Graph 1 – Multilateral real exchange rate, 1986-2006
(Second semester 1986 = 1)



Source: Authors' elaboration based on Central Bank and ECLAC

labour cost in constant dollars did not fall because non-tradable goods and services' prices and nominal wages rose in the first half of the nineties. Fluctuations in the multilateral real exchange rate around the trend were mainly caused by exchange rate fluctuations in trade partner countries, particularly in Brazil. The appreciation accentuated as a consequence of the strengthening of the US dollar, and after the Brazilian devaluation in 1999.

Secondly, despite the high credibility enjoyed for a long time by the exchange rate commitment (as measured, for instance, by the interest rate differentials), private sector savers showed preference for dollar-denominated deposits while banks hedged their balance sheets against exchange rate risk by offering dollar-denominated credits. Consequently, as from the early steps of the Convertibility regime, there was a persistent trend towards a growing proportion of dollar-denominated assets and liabilities in the local banking system. This proportion grew to over 60 per cent in the last years of the regime. The dollarization of local savings and credits played an important role in agents' perceptions and behaviour. The dollarization of private sector assets was perceived as a hedge against the risk of devaluation and thus contributed to the reduction of the volatility of local portfolios and enabled extension of the maturity of contracts. Through these effects it has also contributed to lengthen the survival of

the Convertibility regime. While there had been a dramatic run from local deposits in the crisis that followed the Mexican devaluation, things happened to be different in the period that ensued before the Asian and Russian-Brazilian crises: total deposits in the banking system remained strong during 1997-99 and only started to fall by late 2000. On the other hand, the exchange risk burden rested not only on foreign investors and banks and big firms indebted abroad, but also on numerous local bank debtors with dollar-denominated liabilities but incomes in pesos.

The appreciated exchange rate and the partial dollarization of the local banking system were not necessary ingredients of a currency board regime. They arose from specific local circumstances, but both constituted basic characteristics of the Convertibility regime and significantly influenced its performance and dramatic breakdown. The long-lasting real appreciation of the peso had, in particular, strong negative effects on sectors producing tradable goods and on the labour market, as we will analyze below.

An extremely rigid monetary system

The Convertibility regime succinctly described above was an extremely rigid setting. The rigidity did not follow exclusively from the legal rules but also from the actual behavior of markets. For instance, the flexibility of the real exchange rate vis-à-vis negative external shocks would have required a significant downward flexibility of domestic non-tradable goods prices. Actually, no significant nominal deflation took place either in the 1995 recession or in the post-1998 depression, in spite of the observed significant flexibility of low-skilled wages.

The Convertibility regime setting determined two features of the macroeconomic performance. Firstly, there was a growing external gap. The combination of trade opening with an appreciated exchange rate resulted in a chronic trade balance deficit. The trade balance reached equilibrium or surplus only under conditions of deep recession. The trade deficit together with the growing structural deficit in the factor services account generated a rising current account deficit. To sustain any positive rate of growth the economy necessitated substantial and increasing external capital inflows.

Up to a certain point, the currency board regime played its intended role as an automatic stabilizer of the external accounts. However, under the Convertibility regime, even the deepest recessions left the current

account with a substantial deficit, also causing a very high unemployment rate. These features weighed on the negative side of international investors' perceptions and tended to undermine its positive side. Hence, the Argentine version of the currency board was far from dissipating the risk of default.

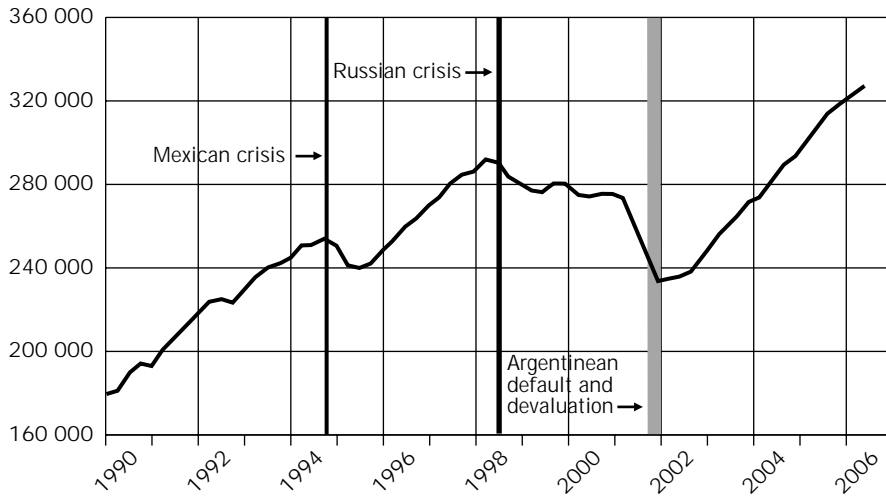
Secondly, the volatility of the international financial conditions confronted by the country was mechanically transmitted to both domestic activity and employment levels. The correlation between national performance and the behavior of international capital markets is a common characteristic of emerging market economies, but in the Argentine case the correlation was accentuated since the macroeconomic regime lacked any significant monetary and nominal flexibility to compensate for external impulses in both directions.

An example of a more general pattern of crises

The Argentine macroeconomic experience in the nineties is an example of a more general pattern of external crises. Many of the crises that took place since the seventies followed a boom and bust cycle path, generated by significant capital inflows to small and badly regulated domestic financial systems, in fixed (or semi-fixed) exchange rate environments.⁷ The stylized features of this cycle can be described as follows. It begins with an expansionary phase caused by capital inflows typically attracted by high interest rate differentials between local and foreign assets in contexts of credible fixed exchange rates. Domestic credit and aggregate demand expansions follow. Real exchange rate appreciation emerges as a consequence of inflation generated by demand pressures, residual price increments (in cases of exchange rate stabilization programmes), or both. The current account worsens as a result of the increasing net imports flow caused by both the exchange rate appreciation and the demand expansion. The external financial needs rise and lead to debt accumulation. Consequently, external vulnerability of the economy progressively increases. As the perceived risk increases, capital inflows tend to slow down and interest rates rise, pushed by rising country risk and exchange risk premiums. Reserves accumulation stops and a contraction begins. Higher interest rates and capital outflows give place to an illiquid financial scenario “à la Minsky” (1975). Moreover, the rise in the real

⁷ A formal model, inspired by the Argentine and Chilean experiences in the late seventies-early eighties can be found in Frenkel (1983). English versions are presented in Taylor (1991 and 2004) and Williamson (1983). Asian and Latin American crises in the nineties are discussed and analyzed in this vein by Taylor (1998) and Frenkel (2003a).

Graph 2 – Seasonally-adjusted real GDP
(Quarterly data in millions of pesos of 1993)



Source: Calculation by the authors, based on data from the Ministry of Economy

interest rate, an endogenous consequence of increasing external fragility, sharpens the contraction of economic activity creating additional sources of financial distress. Finally, the exchange rate regime collapses simultaneously with a financial crisis.

The path of Argentina's economy under convertibility and the consequent 2001-2002 crisis is a clear example of this kind of cyclical dynamic.⁸ The main stylized facts of this pattern were observed twice during the decade. The first cycle was between 1990 and 1995 (the year in which the economy was stalled by the spillover effects of the Mexican crisis), while the second one was between 1996 and 2001 (see Graph 2). The first of these cycles did not result in an exchange-rate crisis, but it did cause a recession and a financial crisis in 1995.

International financial context

The various positive changes that took place in the international financial context at the beginning of the nineties had a strong impact at the domestic level. International interest rates fell sharply as from 1989, while access to external finance was restored. In 1991, capital inflows

⁸ For an extensive treatment of the macroeconomic dynamic and the crisis, see Damill and Frenkel (2003).

began to reach substantial levels. As well as expulsion factors (especially the fall in interest rates in the developed world), which explained much of the flow of capital to emerging markets in the early nineties; domestic “attraction” factors were also important. In the case of Argentina, special mention may be made of the privatization process begun in 1990, financial liberalization, and the application of the stabilization programme. Thus, in the early years of the decade, the net inflows of funds exceeded the current account deficit, making possible a rapid and substantial accumulation of international reserves, the initial level of which was very low. The accumulation of reserves fed the increase in the supply of money and credit, and this, together with the decline in both external and domestic interest rates, led to rapid growth of aggregate demand and GDP. The increase in GDP, in its turn, affected the balance of payments, since it stimulated imports and thereby contributed to the current account deficit. Trade openness and the appreciation of the exchange rate acted in the same direction.

The growth led by capital inflows continued up to 1994. In that year, however, there was a rise in international interest rates (following the Federal Reserve’s decision to increase its discount rates as from February). This began to affect the inflow of funds negatively and, because of the growing current account deficit, the foreign exchange reserves stopped growing.

A crush on inflation

It may be noted that, in this first stage, the stabilization programme was very effective in checking inflation. Following its adoption, there was an immediate slackening in price rises. In the case of internationally tradable goods, for which the wholesale price index is a good approximate indicator, the fixing of the exchange rate had a marked impact. Inflation at the wholesale level went down immediately to levels of the order of 1 percent per month and continued to go down. This index registered a total variation of 12.5 per cent from the beginning of the plan up to December 1994, which is equivalent to a little over 3 percent in annualized terms and is in line with international inflation in the same period as measured, for example, by the United States consumer price index.

The Argentine consumer price index (CPI), in contrast, rose by 58.5 per cent over the same period. Although in this case, too, there was a sharp fall in the rate of inflation, the residual inflation built up in the first three years of the programme was very substantial. This is explained

by the greater weight of non-tradable goods and services in the calculation of the CPI, and therefore reflects the change in relative prices over the period. The divergence between the variations of these two price indexes disappeared towards the end of 1994, however. From that time, and up to the final crisis of the macroeconomic regime in December 2001, monthly inflation rates always tended to be very close to zero, with a predominance of slight negative figures.

Graph 1 and Table 1 give information on the evolution of the real exchange rate. It is important to note that this variable, which had reached extraordinarily high levels during the exchange-rate stampede which set off the crises of hyperinflation in 1989 and 1990, dropped almost vertically in the course of the latter year, that is to say, before the launching of the convertibility plan.

As may be seen from Table 1, already in the period immediately before the launching of the stabilization plan, real parity was almost 58 percent of its average level in the 1986-1988 period (that is, without considering the peaks of 1989-90). Since then, a long period followed in which the variations in real parity were relatively minor, until the monetary regime broke down in December 2001.

Table 1 – Argentina: Average real multilateral exchange rate in different periods – (Second half of 1986 = 1)

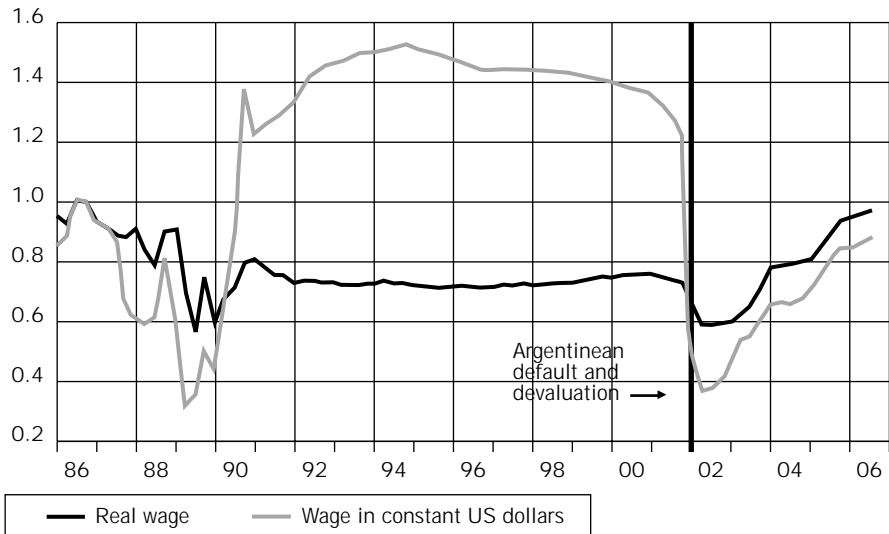
Period	Real exchange rate
1986-1988	1.24
1986-1990	1.39
1990:4-1991:1 ^a	0.72
1991:2-1994:4 ^a	0.58
1995-2001	0.56
2002	1.18
2003-2005	1.13

^a Quarters

Source: Calculation by the authors, based on data from the Ministry of Economy and Central Bank

Graph 3 shows data on wages in dollars and average real dollars in the manufacturing sector. Once again, in the case of wages in dollars, the drastic change at the beginning of the period should be noted. Here, as it was the case with the real exchange rate, the subsequent variations may be considered as being of second order.

Graph 3 – Average real wage in the manufactures (deflated by CPI) and average wage in constant US dollars (second semester 1986=1)

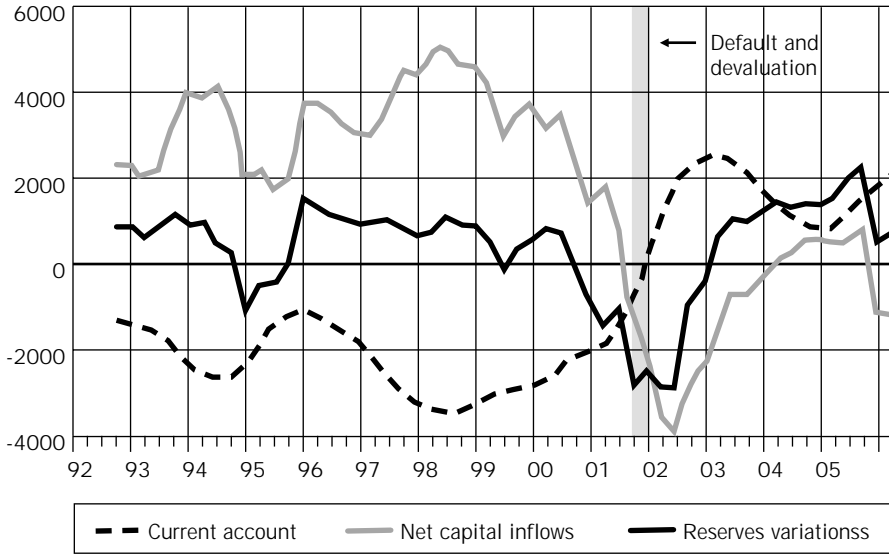


Source: Calculation by the authors, based on data from INDEC and the Central Bank

Real wages in manufacturing, in contrast, behaved very differently, which also reflected the process of exchange-rate appreciation. As the prices of non-tradable goods and services measured in dollars rose considerably, and these goods and services weighed heavily in the CPI, wages deflated by this index show some initial decline and then a quite stable level during the decade.

As in the stylized cycle described above, during the expansionary phase that lasted from 1990 to 1994, the economy became increasingly vulnerable to unfavourable external shocks. As Graph 4 shows, the current account deficit tended to rise. At the same time, external indebtedness was rising. The dependence on inflows of funds was thus further increased. In other words, the macroeconomic framework became more vulnerable to changes that could more or less abruptly affect the availability of external finance. This source of vulnerability became more evident in the case of Argentina because the regime involved complete liberalization of capital flows.

Graph 4 – Balance of payments, 1992-2005
(Four quarters m.a. in millions of dollars)



Source: Authors' elaboration based on Ministry of Economy

Coping with financial contamination

The rise in international interest rates in 1994, which was already mentioned, and its consequences for the inflow of capital and the inherent mechanics of the convertibility regime could of themselves have led to a contractive phase. At the end of that year, however, Mexico suffered a run on the peso that ended in heavy depreciation. The effects immediately spread to Argentina. Consequently, instead of the country registering an endogenous adjustment in line with the typical workings of a currency board regime, the external shock led to a massive and rapid outflow of funds early in 1995, with a parallel very marked rise in domestic interest rates. The stock of foreign exchange reserves went down abruptly and there was a corresponding contraction in liquidity. Aggregate demand behaved similarly. In this phase, the unemployment rate (which had actually begun to show an upward trend two years earlier, when the economy was still expanding very strongly) rose substantially and from then on always remained at historically very high levels (see Graphs 5 and 6).

Nevertheless, the recession in the middle of the decade was very short. A powerful set of external and domestic financial support meas-

ures, arranged with the coordination of the International Monetary Fund (IMF), made it possible to quickly change the negative tone of expectations. In addition, by various means and in spite of the limitations imposed by the convertibility rule, the government carried out intensive monetary activity designed to shore up the banks and thus stop the financial crisis from deepening.⁹

Thanks to the favourable effects of external financial support, it was possible to keep the monetary regime intact, and towards the end of 1995, a new spell of expansion began. The monetary mechanism behind this recovery was the same one observed in the early years of the 1990s. Access to external funds gradually recovered; the inflow of capital began to exceed the current account deficit (which had gone down as a result of the recession), and the foreign exchange reserves recovered once again, as did the supplies of money and credit. The elements of the cyclical dynamic were again put in motion.

This new expansionary phase had similar features to the first one, but it was to be shorter.¹⁰ The risk premium went up in mid-1997, after the Thai devaluation, and growth slackened. The Russian crisis in 1998, which also had a very strong impact on Brazil, brought the period of expansion to an end. Private inflows of funds declined from then on, and the accumulation of reserves slowed, and then became negative somewhat later. As a result, a phase contraction of GDP began in mid-1998, culminating in the collapse of 2001-2002, in which, among many other events, there was the steep depreciation of the peso already referred to earlier, and the government began to default on a large part of its external and domestic financial commitments.

⁹ Notwithstanding, the legal restrictions were respected. The expansion in money supply during 1995 came from several sources, including reductions in reserve requirements to banks and the utilization of credit lines from multilateral organizations. The Convertibility Law also gave the Central Bank the possibility of backing a maximum of 20% of the monetary base in bonds of the Argentine government denominated in foreign currency. This margin had not been utilized before the crisis, so that the monetary authorities were able to issue money by employing it without breaking the legal limits. The margin was also widened in 1995 to give more room for the Central Bank to support the illiquid banks.

¹⁰ Beyond the similarities, the second cycle of the nineties differed from the first one in many respects. We mention one of them. During the economic expansion of the early nineties, private inflows were predominant. In contrast, the second expansion was bolstered mainly by capital inflows directed to the national government that issued further foreign debt than its external needs. In this period, the public debt started to increase exponentially. Meanwhile net capital inflows directed to the private sector recovered slowly and, from mid-1998 on, they stopped flowing in important amounts. Then, an abrupt outflow started in late 2000. Thus, during the second cycle, the public sector played a crucial role in the financing of the reserves accumulation. Instead, the private sector turned to be a net demander of foreign currency. For a detailed explanation see Damill (2000).

Final phase of the regime before its collapse

The story of the final phase of the convertibility regime can be stated in a simple way as follows. To begin with, the unfavourable turn in the external financial situation which took place in 1997-1998, after the Southeast Asian and Russian crises, found Argentina with a high and growing current account deficit, an over-appreciated currency, and an evident shortage of policy instruments for dealing with this set of problems, because of the rigidity of the macroeconomic framework adopted. Not surprisingly, in these conditions the country risk premium rose sharply and remained high, while access to external funds became more and more problematical. The subsequent increase in the debt interest burden had a negative impact on all debtors, including the public sector. Since 1997, in addition to the deterioration of the foreign financial environment, Argentina suffered a series of real shocks, including a strong fall in the average price of exports, a contraction in foreign demand for locally produced goods, and an additional real appreciation caused for the strengthening of the US dollar and the Brazilian devaluation of 1999.

Given the legal inability to pursue a counter-cyclical monetary policy, the government had to rest on fiscal and supply side policies to bear with the depression. First the Menem's Administration and since December 1999 the new one led by De la Rúa tried to revert the contractionary trend through several fiscal tightening programmes. In their view, the main cause of the economic depression was not the exchange rate appreciation and the external and financial vulnerability, but fiscal mismanagement.¹¹ Fiscal discipline would entail stronger confidence, and consequently the risk premium would fall bringing interest rates down. Therefore, domestic expenditure would recover pushing the economic out of the recession. Lower interest rates and an increased GDP would, in turn, reestablish a balanced budget, thus closing a virtuous circle.

However, with the economy locked inside an external debt trap, the 'confidence shock' expected to revert the trend did not materialize. Moreover, the rounds of contractionary fiscal policies only reinforced the deflationary dynamics and the pessimistic expectations. As the improvement in the primary balance of the public sector accounts was not enough to

¹¹ Convenient as it was for supporters of the monetary setting of the nineties, the view that the macroeconomic unbalances that brought to the crisis had originated in fiscal mismanagement acquired wide acceptance. We analyzed and questioned this view in depth in several previous works. See for instance Damill and Frenkel (2003) and Damill, Frenkel and Rapetti (2005).

compensate for the increasing interest burden, the public deficit tended to grow and public liabilities kept growing very fast.

Besides some initiatives on the financial front¹², conflicting processes went on (i.e. the withdrawal of bank deposits and the contraction of international reserves). Finally, in December 2001 the government established hard restrictions on capital movements and on withdrawals of cash from banks (the so-called 'corralito'). The purposes of the measures were to avoid either the generalized bankruptcy of the banks or the violation of the currency board monetary rule. But their main objectives were to hold back the demand for foreign currency, preserve the stock of reserves and avoid the devaluation (i.e. the formal abandonment of the convertibility regime). This was also the last drastic move attempting to prevent the default. Yet, the measures did actually represent the end of the regime.

The December 2001 measures contributed to deepen the already strong social and political tensions. After a few days of social unrest and political commotion the country witnessed the resignation of the government followed by a series of ephemeral presidents. One of them announced to the Congress the decision of defaulting on a portion of the public debt, and resigned a few days later. In the first days of 2002, with a new president, Argentina officially abandoned the currency board regime and the one-to-one parity of the peso to the US dollar.

2. The labour market in the nineties

The features of the macroeconomic evolution in Argentina under the convertibility regime described above were reflected in developments in the labour market. The initial achievements of the stabilization programme and reforms had positive effects in terms of higher levels of activity and lower inflation rates. On the one hand, greater economic activity meant greater demand for labour. On the other, the decline in inflation reduced the negative impact of the "inflation tax", which hit those with the lowest wages hardest.

These consequences are typical of programmes of this type, at least in their initial phase. Other effects of such programmes, however, are

¹² Since taking office, the government achieved three financial agreements with the IMF and also launched two important 'voluntary' debt swaps in the second half of 2001.

often of a negative nature. Privatization processes are often followed or preceded by business rationalization measures that involve substantial staff cuts. Adjustments in the expenditure of national, provincial and municipal levels of government may have similar effects, usually involving the reduction of employment and wages. These negative consequences on employment and wages are a “once only” phenomenon.

The joint impacts of trade openness and exchange-rate appreciation, for their part, deserve special mention, since they have lasting adverse consequences for employment in the production of tradable goods, especially in the manufacturing sector.

An employment cycle is clearly observable in Argentina under the Convertibility regime. As we shall see in more detail in the following section, the aggregate employment rate tended to rise between the launching of the convertibility programme and 1993, subsequently going down steadily and standing at the end of 1996 well below the 1990 employment rate. The contraction mainly affected the jobs of male heads of household working over 35 hours per week, and was concentrated in employment in manufacturing. Although the privatization operations and the fiscal adjustment of the provinces had negative effects on employment, the heaviest negative impact came from the restructuring and concentration of activities in the production of tradable goods caused by trade openness and exchange-rate appreciation.¹³ The negative impact on employment caused, in turn, high rates of unemployment. High unemployment, both by its very nature and by the downward pressure it exerts on wages, caused a persistent trend towards greater inequality of income distribution.

Employment, underemployment and unemployment in Argentina in the 1990s

In this section, we will present empirical evidence on the evolution of labour market conditions in Argentina in the circumstances just described. We will begin by examining the evolution of aggregate employment, underemployment and unemployment in the decade in question.

¹³ The important effects of openness with exchange-rate appreciation in the labor market in Argentina in the nineties are examined for instance in Damill, Frenkel and Maurizio (2002) and Damill and Frenkel (2006).

The series analyzed below refer to the urban population and are taken from the Permanent Household Survey (PHS), which the National Institute of Statistics and Censuses (INDEC) carried out twice-yearly, in May and October.¹⁴ Unless otherwise indicated, the series are defined as percentages of the total urban population. They are:

PART = participation rate;

EMPL = employment rate;

FTEEMPL = full-time employment rate;¹⁵

SUB = involuntary underemployment;

U = unemployment rate.

Graph 5 shows the evolution of these variables since the early 1980s. Firstly, it may be observed that the full-time employment rate shows a marked downward trend, dropping from 35-36 per cent in the early years of that decade to 32 per cent in the first half of 1990 and 27.6 per cent in the second half of 2001.¹⁶

In addition to this negative trend, FTEEMPL also displays clear correlation with the macroeconomic cycle. As in the case of the gross domestic product (GDP), this variable displays two clear cycles in the 1990s. It goes up as from 1990, then registers a pronounced fall reaching its lowest point in 1996, goes on to rise once again with the second period of expansion in the decade, but subsequently goes down again as from 1998.

It is important to note, however, that the highest level reached by FTEEMPL in the period of expansion in the early 1990s was registered in the second half of 1992, well before the turning-point in GDP observed at the end of 1994, after the Mexican crisis. Thus, in 1993 and 1994, when the economy was still expanding at a significant rate, the ratio between full-time jobs and the total population was already going down.

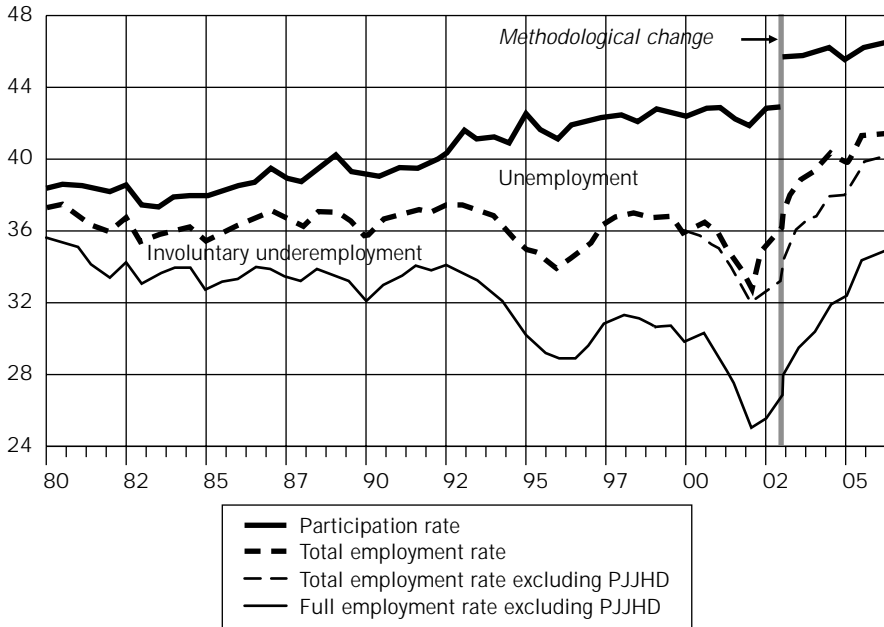
Between the high point of 34.14 per cent and the minimum observed in the second half of 1996, FTEEMPL fell by approximately

¹⁴ The methodology and frequency of the PHS have recently been changed, as we describe below.

¹⁵ In the survey, an individual is considered to be employed full time if he works at least 35 hours per week. This group also includes those who, although they worked less than 35 hours per week, do not wish to work more hours (i.e., this variable includes "voluntary underemployment").

¹⁶ As in Graph 5, in this section we have used half-year periods. Thus, the first half of the year corresponds to the survey carried out in May, while the second half corresponds to that carried out in October, so that 2000:1, for example, stands for the first half of 2000. Furthermore, in most cases in this section the % sign stands for "percentage points of the population". Henceforth, however, whenever there may be any ambiguity, we will use the expression "percentage points of the population" in full when referring to measurements of this nature.

Graph 5 – Labour market indicators: Participation rate, Employment rate, Employment rate excluding PJJHD
Full employment rate excluding PJJHD (as % of total urban population)



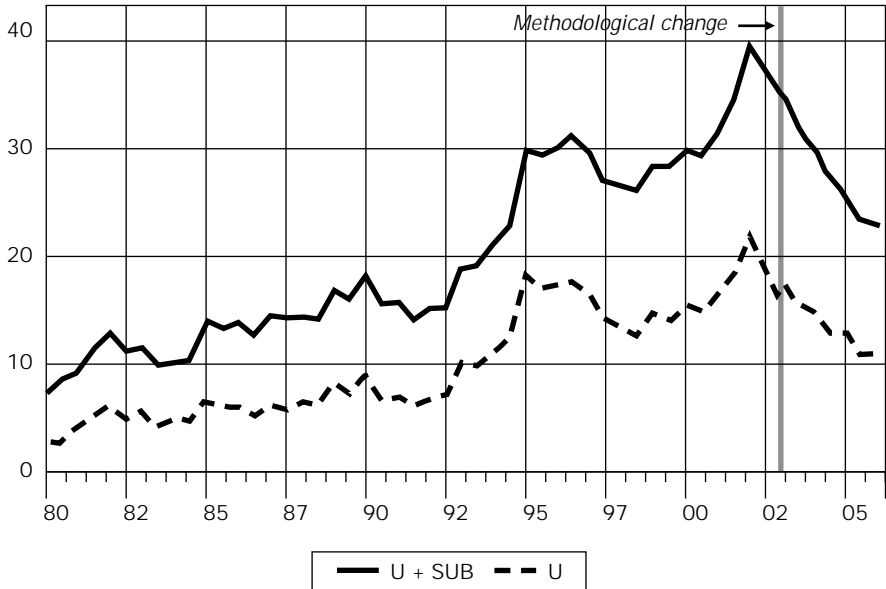
Source: Calculation by the authors, based on data from INDEC

5.2 per cent. It then recovered by about 2.4 per cent, reaching a new peak in the first quarter of 1998. It should be noted, however, that the latter value is well below the maximum attained in the previous period of expansion.

The subsequent decline went along with the recessionary trend, both in the period of moderate contraction, up to mid-2001, and in the sharp fall in activity that occurred in the second half of 2001. At that moment, towards the end of the convertibility regime, FTEMPL was 6 per cent below the level it had reached in the first half of 1991.

The ratio between total employment and the population (EMPL) also showed a downward trend in the early 1990s, but this was considerably less pronounced than in the case of FTEMPL, indicating that the rate of underemployment (involuntary underemployment), SUB, tended to rise in that same period. The increase in SUB became more marked in 1999-2000.

Graph 6 – Unemployment (U) and Involuntary Underemployment (SUB)
(% of urban active population)



Source: Calculation by the authors, based on data from INDEC

Furthermore, the evolution of SUB was counter-cyclical: it tended to rise when FTEEMPL fell and to fall when the latter rose. As a consequence of this behaviour of underemployment, EMPL is less closely linked with the economic cycle than FTEEMPL.

Finally, the rate of participation of the population in the labour force (PART) shows a markedly positive trend, not correlated with the macroeconomic cycle. Starting from around 38 per cent in 1980, it went up to 39 per cent in 1990 and then rose sharply still further, reaching 42.8 per cent in the first half of 2001. Throughout the convertibility period, the trend of PART corresponded to an increase of approximately one percentage point of the urban population every three years. The main reason for this behaviour was the sustained increase in female participation in the labour force. This participation is still low in Argentina by international standards.

As a result of the positive trend of PART and the relative stagnation of the employment rate, the unemployment rate (U) rose sharply in the 1990s, with a marked upward jump in the 1992-1995 period (see Graph 6).

The impact of the 2001-2002 crises caused a further unfavourable jump in these indicators. The urban open unemployment rate rose to a peak of 21.5 per cent in May 2002 but began to go down thereafter. Underemployment, for its part, reached a peak of 19.9 per cent of the economically active population in October 2002 but also went down afterwards when the economic recovery began to take hold.

3. The post-convertibility macroeconomic regime and performance

The Convertibility regime was abandoned in the midst of a chaotic situation. The massive flight to external assets that precipitated the collapse of the regime continued after the devaluation of the peso and the default. The government decided to replace the currency board for a dual exchange rate regime, meanwhile maintaining the exchange controls and the 'corralito'. The foreign exchange (FX) market was split in two segments: an official market for certain trade and financial operations with a fixed nominal parity 40 percent higher than before (1.40 pesos per dollar), and a floating rate market open to the rest of foreign exchange operations. Soon after, the IMF let the new administration know that there would be no negotiations with the country while the dual exchange rate regime and the controls were maintained. Then, the government decided to unify the FX market and let the peso float. Once the local currency started to float, the parity rose abruptly and after a few months reached levels close to 4 pesos per dollar, in an environment of expectations of further increases.

The overshooting led to a rise in local prices. Although the pass-through was low in comparison to other devaluation experiences, four months after the devaluation the CPI inflation had accumulated a 21 per cent increase.¹⁷ This caused an average fall in real wages of almost 18 per cent and a consequent recessionary impulse on aggregate demand.

¹⁷ Several factors contributed to explain the lower pass-through, including the freezing of prices of public utilities (many of them were dollarized and some of them indexed to US inflation, as established in contracts signed in the nineties; thus, the government had to intervene to prevent the peso devaluation to have a full impact in these prices). Another important buffer was the significant excess supply in the labor and goods markets. On the one hand, the very high unemployment rate weakened any initial wage resistance to the impact of devaluation and, on the other, producers of non-tradable goods and services to the domestic markets found it impossible to pass to prices the cost increases of intermediate goods caused by the devaluation.

Contrary to what was expected, the contractionary balance sheet effect of the devaluation was small, mainly as a consequence of the official intervention. When the FX market was unified and the exchange rate was freed to float, the government decided to convert to pesos most of domestic debts contracted in dollars (bank credits, rents, etc.) at a one-to-one rate, thus neutralizing most of the effects of relative price change on the debtors' balance sheets. In contrast, banks' deposits originally denominated in dollars were converted to pesos at 1.40 pesos per dollar (plus indexation to the evolution of CPI inflation).¹⁸ Together with the peso conversion, the authorities unilaterally decided to extend the maturity and duration of all deposits, including those originally contracted in pesos. In exchange, private depositors received certificates for the reprogrammed deposits. This intervention was later known as the 'corralón'.

The dramatic fall in output and employment continued in the period immediately following the end of the convertibility. However, this trend did not last for too long. Only one quarter after the devaluation and the default, the contraction came to a halt and a recovery was already at work. At this time most of the analysts -including the IMF's staff- were expecting a hyperinflation process led by the exchange rate overshooting and the continuation of the contractionary trend.

Since the second quarter of 2002 to mid 2006, GDP has been growing at an 8.3 per cent average annual rate. By mid-2005 it had already surpassed the historical maximum level reached in 1998 (Graph 2).

Domestic factors were the triggers of the economic recovery

It has been assumed in some circles that the recovery was mainly a result of a favourable change in the foreign context, but this is not supported by facts. Evidently, the increase in export prices and the decline in foreign interest rates, for example, have been positive factors only later, contributing to consolidate a very fast economic expansion, but they cannot explain the sudden stop of the economic contraction and the beginning of the recovery early in 2002.

¹⁸ Later on, the government issued new debt to compensate the banks for the balance sheet effect of the asymmetric 'pesoification'.

¹⁹ Later on, the improvement in the foreign financial environment would contribute to the acceptance and success of the Argentine proposal of debt restructuring, but this was only in 2004-2005.

On the one hand, the default on the public debt had isolated Argentina from the international capital markets. Thus, given this “de facto” segmentation, the decline in foreign interest rates could not have had any significant favourable impact¹⁹. It is also worth remembering that the recovery started when net capital inflows were still negative.

On the other hand, neither the evolution of export prices nor the terms of trade can explain the reversion of GDP trend in 2002. As Table 2 shows, the average price of exports was still falling in that year, and it also was considerably lower than the 1997-98 average level, for instance. Moreover, exports at constant prices of 1993 amounted to only about 13 per cent of GDP by the end of 2001; therefore the impact of export price changes on aggregate domestic income was small in any case.

Table 2 – Indexes of average export and import prices, and the terms of trade, 1996-2005 (2000=100)

Year	Price of exports	Price of imports	Terms of trade
1996	114.9	110.3	104.2
1997	112.0	109.7	102.1
1998	102.0	104.3	97.8
1999	92.2	99.2	92.9
2000	100.0	100.0	100.0
2001	97.9	98.2	99.7
2002	86.1	95.7	89.9
2003	93.6	96.9	96.6
2004	102.6	104.3	98.4
2005(*)	104.2	108.6	95.9

Source: ECLAC

(*) Calculation by the authors, based on data from INDEC

It was true that the average price of imports was falling in 2001-2002, but with the huge recession of 1998-2001 imports had plummeted to figures between 9 and 10 per cent of GDP in late 2001. Again, then, the domestic impact of these price changes was considerably small. Furthermore, the table also shows that the terms of trade were actually falling in 2002. They recovered in 2003-2004 but without reaching the 2000 level.

Thus, when the economic recovery ignited, the changes we have just commented on either had the wrong sign or were insignificant to explain the rebound of GDP.

Therefore, it is straightforward to conclude that domestic factors had the main bearing in explaining the 2002 turning point. The recovery was actually bolstered by the shift in the relative prices caused by the devaluation and also by an adequate set of policies that, despite its flaws and ambiguities, nevertheless succeeded in stabilizing the FX market and domestic prices and recuperating the basic macroeconomic equilibria. As we have already mentioned, favourable external conditions, such as high international commodities prices and low international interest rates also contributed to this process, later. In the following subsections we analyze the principal features of the macroeconomic performance of Argentina in the post-convertibility period.

The main characteristics of the economic recovery

The path of economic recovery can be divided in three periods. In the first one, comprising the second and third quarters of 2002, the GDP expansion was relatively weak and rested on the effect of the real depreciation on international trade variables. Domestic absorption (particularly, private consumption and investment) kept on shrinking, as it happened along the previous depression, though at a low pace. Therefore, it was not the aggregate demand that stopped the decline in the activity level. In effect, the ongoing fall in employment and real wages²⁰, the liquidity constraints generated by the 'corralito' and 'corralón', and the high uncertainty on the future values of the principal financial variables imposed important limitations to the recuperation of private expenditures. In this phase, exports but specially import substitutions were the expansive factors: favoured by the change in relative prices, the local production started to provide an increasing proportion of aggregate demand.

It is remarkable that this phase started, despite the short-term contractionary effects of the depreciation still in motion, while the country was still immersed in a context of accentuated financial instability and political uncertainty. It is especially notable that the recuperation took place while financial variables were still following a conflicting path. As we will show below, the nominal and real depreciation, the withdrawal of bank deposits, the capital flight, the erosion of international reserves, and the rise in the domestic interest rates were still taking place when the third quarter of 2002 started.

²⁰ Although at much lower pace, both real wages and employment continued to fall during this period.

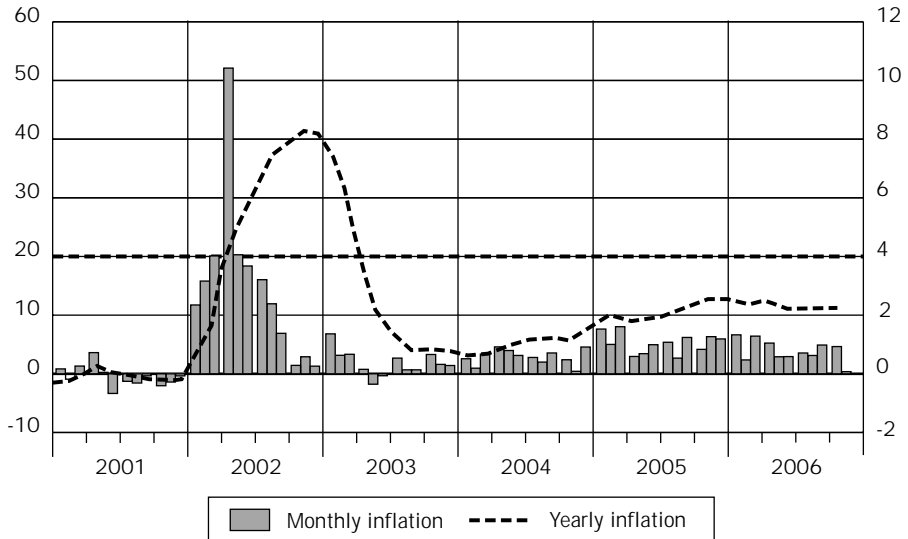
After this short initial stage, a second period of the recovery began. Along this phase, it was led by the increase in the domestic demand components. The normalization of the behaviour of the financial variables along the third quarter of 2002 certainly helped to create a more stable environment, so that the private sector could take advantage of the opportunities provided by the change in relative prices. Domestic absorption would grow at a 12.7 per cent annual rate and would explain more than the entire rise of GDP in this period, extended between the third quarter of 2002 and the second quarter of 2004. On the other hand, net exports started to work as a contractionary force, mainly because of the rapid recuperation of imports but also due to a still weak performance of exports. Private consumption showed an important dynamism, growing at a 9.4 per cent average annual rate and explaining 67.4 per cent of GDP growth in the period.

Several factors accounted for this performance. Among them the launching in the second semester of 2002 of an unemployment subsidy programme (the so-called 'Plan Jefas y Jefes de Hogar Desocupados') should be underlined. It provided income to about 1.8 million of beneficiaries (approximately 11 per cent of the active population). Secondly, after an important downturn of around 25 per cent, real wages started to recover since the fourth quarter of 2002, as a consequence of both the deceleration of inflation and the rise in nominal wages. After reaching a peak in April 2002, inflation started to slow down and since the end of that year the monthly inflation rate tended to be lower than 1 per cent for the subsequent two years (see Graph 7). The improvement in nominal wages was associated with a rapid fall in unemployment, and was also helped by an official policy consisting in several lump-sum rises in private sector wages determined by decree during 2002-04 (Frenkel, 2004a).

The fall in the unemployment rate was due to the important recuperation in full-time employment favoured not only by the economic expansion but also by the real depreciation. As we discuss below, there is significant evidence showing that a depreciated or competitive real exchange rate tends to increase the labour intensity of output, given a certain activity level or growth rate. So, the employment recuperation stimulated private consumption through two effects: on the one hand, by increasing the number of wage earners and, on the other, by contributing to the rise in real wages.

Lastly, it should also be mentioned that the devaluation had a positive wealth effect on private sector's foreign assets holdings. These assets

Graph 7 – Yearly CPI inflation rate and monthly CPI inflation rate 2001-2006 (right axis) (ln %)



Source: Calculation by the authors based on data from INDEC

-that nowadays surpass 120 billion dollars for the non-financial private sector- considerably increased their value in relation to domestic goods and assets such as real estate and land.

Investment showed a remarkable dynamism, growing at a 40.9 per cent annual rate along this second phase and contributing in 55 per cent to GDP growth. This behaviour is in part a result of the gradual normalization of the financial environment. However, it should be stressed that such a recovery took place in a context of accentuated credit rationing, both external and internal. The investment was apparently financed to a great extent by higher profits retained by firms. The 'wealth effect' resulting from the significant external asset holdings of the private resident sector mentioned above, may have contributed as well. This effect is the principal factor behind the rapid expansion of both residential and corporate construction, given the lack of bank credit during this period. The construction activity explained 56 per cent of the increment in investment along this second phase. The other 44 per cent was due to investment in capital goods, especially those imported, which grew 310 percent between the third quarter of 2002 and the second quarter of 2004.

Finally, the effect of net exports on the economic recovery was contractionary in this second period, as we have already mentioned. This basically resulted from the recuperation of imports, which doubled in only seven quarters. The demand for foreign equipment was one of the major elements in this rapid increase, together with intermediate inputs imports. On the other hand, there was a reduction in the exports rate of growth. Despite this behaviour of exports and imports, the trade surplus remained close to the high levels generated by the crisis.

From the third quarter of 2004 onwards, exports started a faster expansion, at a yearly average rate of 11 per cent between that moment and the second quarter of 2006, giving birth to a third phase in the economic recovery process. During this new phase, economic growth maintained momentum, but it rested not only on domestic demand expansion but also on exports dynamism. GDP expansion has been still explained basically by domestic demand, but the effect of net exports, that had been negative in the previous phase, was close to nil in the latter period, in spite of the fast growing trend of imports. The strategy consisting in preserving a competitive exchange rate is surely a crucial factor behind the improvement in export performance. The lag in the reaction of exports to the new set of relative prices does not differ from other international experiences, such as Brazil after the 1999 devaluation. It seems reasonable that tradable firms required time to take advantage of the competitive RER, in order to re-orient their production and to establish commercialization channels abroad.

In early 2005, the GDP finally surpassed its pre-crisis maximum level, attained in 1998. At the time we write these lines, in late 2006, the activity level keeps on expanding at an impressive speed, between 8 and 9 per cent yearly. It is important to notice that the current process presents significant differences with other economic growth episodes in Argentina's economic history. Among them, and in contrast to the recurrent fiscal and external imbalances of the past, the current macroeconomic configuration stands out with the existence of external and fiscal surpluses, as we show in the next section.

External and fiscal adjustment

The adjustment experienced by the Argentinean external sector in recent years took place to a great extent before the devaluation, as showed in Graph 4, where the improvement in the current account since 1998 can be seen.

Actually, the abrupt economic contraction that characterized the end of the convertibility generated an important trade surplus. The trade balance exhibited a deficit higher than 3 billion dollars in 1998. It rapidly decreased from then on and turned into surplus, due to the reduction in the volume of imports. In 2002 the balance was higher than 17 billion dollars, and remained over 16 billion in 2003 (and over 12 billion in 2004 and 2005). The trade surplus caused the change of sign in the current account balance. In recent years it has shown positive results even taking into account the interests accrued by the debt in default.²¹ In fact, the macroeconomic policy has been facing the problem of sustaining the real exchange parity in order to preserve the incentives to investment in the tradable goods sector in a context of international currency excess supply.

As can be seen in Table 3, a strong adjustment in the public accounts has also taken place together with the external adjustment process we have just mentioned.

The improvement in the Consolidated Public Sector global result that took place between 2001 and 2005 was equivalent to 7.6 points of GDP. This result passed from a global deficit of 5.6 per cent of GDP in 2001 to a 1.9 per cent surplus in 2005.

Which are the factors explaining the adjustment in the fiscal cash flow results? About a third of it derives from an improvement in the provinces' balances. This improvement comes from the increase in tax collection facilitated by the recovery and the rise in nominal prices, together with the restraint in expenditure. Meanwhile, more than 70 per cent of the five percentage points adjustment in the national public sector's budget is explained by the improvement in the primary result (+3.6 per cent of GDP). The contraction of interest payments, basically resulting from the default of the sovereign debt and the debt restructuring of 2005, accounts for the rest (-1.4 per cent of GDP).

The rise in the national primary surplus is mainly explained by an improvement in tax revenues (+5.3 per cent of GDP). It is interesting to observe that although the receipts from traditional taxes such as the VAT

²¹ The trade balance and the current account tended to deteriorate during the recent expansion. However, the Graph 4 shows a current account improvement in the 2005-2006 period. This is in part a reflection of accounting procedures: 2005 was the year of the debt restructuring. In the previous periods, after the default, the current account registered interest payments accrued on the defaulted debt but actually not paid. After the restructuring a significant part of these interest payments ceased to be accounted for, replaced by a considerably smaller amount of payments of interest services on the new public bonds.

Table 3 – Fiscal adjustment: Results of the Consolidated Public Sector (CPS)
(as a percentage of GDP)

Concept	2001	2005	Variation (2005-2001)
Total receipts	18,8	23,8	5,0
Tax receipts	13,8	19,2	5,3
Taxes on exports	0,0	2,3	2,3
Financial tax (*)	1,1	1,5	0,4
VAT	3,1	3,5	0,4
Income tax	2,5	3,6	1,1
Other taxes (**)	5,3	6,7	1,4
Other receipts	5,0	4,5	-0,5
Total expenditures	22,0	22,0	0,0
Primary expenditures	12,1	14,9	2,9
Interest services	3,8	2,4	-1,4
Primary result	0,5	4,2	3,6
Total result of the NPS	-3,2	1,8	5,0
Provinces (***)	-2,4	0,2	2,5
Total result of the CPS	-5,6	1,9	7,6

(*) Tax on bank debits and credits

(**) Includes taxes shared with provinces, which are included as expenditures in the Primary expenditures item as transfers to provinces

(***) Including the City of Buenos Aires

Source: Authors' calculations based on Ministry of Economy

and income tax rose significantly, they did not increase substantially when measured as a proportion of GDP. Between 2001 and 2005 they increased by 1.5 per cent of GDP as a whole. The tax on exports is the item that mostly explains the rise in tax revenues (+2.3 per cent of GDP). The exports of soybean and its derived products generated almost one half of the taxes on exports.

Hence, the public sector absorbed part of the effect of the devaluation on the profitability of the tradable goods sector, and was also benefited by the high prices reached by some of the exportable goods, such as soybean and oil. The tax on financial operations established in 2001 also contributed to the increase of tax collection (+0.4 per cent of GDP).

The interest payments on the public debt deserve a separate paragraph. As it can be seen in Table 3, this flow passed from representing

almost 4 per cent of GDP in 2001 to 2.4 per cent in 2005. However, the fiscal effects of the suspension of part of the debt services payments in the 2001-2004 and the debt restructuring of 2005 are significantly higher than what is shown in the mentioned estimation. It cannot be calculated with precision because a significant amount of new debt was issued after the suspension of debt payments. We have estimated that the amount of interests on the public debt in 2004, the year before the restructuring, valued at the 2004 exchange rate, would have represented in that year between 9 and 11 points of GDP. This is approximately equivalent to one half of the total tax collection of the year. These payments would have been certainly incompatible with the economic recovery and with macroeconomic stability. In effect, a crucial aspect of the fiscal financial vulnerability derived from the extremely high proportion of debt in foreign currency, with the consequent exposure to the impacts of the exchange rate variations. The 2002 substantial exchange rate depreciation would have had a harsh impact on the public sector's financial equilibrium. Taking this aspect into account, it can be said that the payments suspension and the following debt restructuring enabled a considerable amount of fiscal savings -either measured in domestic currency or as a proportion of GDP.

However, the most important effect of the default and the end of the convertibility regime was the effectiveness of the instruments of macroeconomic policy which were of crucial importance to take the economy out of the abyss generated by the final collapse of the convertibility regime.

Debt restructuring and fiscal consolidation

A pivotal step to fiscal consolidation after the crisis was the partial restructuring of the public debt. It involved a significant haircut in the nominal amount of the public financial liabilities, as well as an important reduction in interest rates and a considerable extension of average maturity.²²

A first proposal was made to creditors by the Argentinean government in 2003. The authorities recognized a defaulted debt stock of about 87 billion dollars, to be reduced later to 81.8 billion. This amount left aside an important volume of past due interests.²³ In the restructuring

²² These issues are extensively discussed in Damill, Frenkel and Rapetti (2005).

²³ This set of obligations was denominated the 'eligible debt'. It consisted of 158 instruments, issued in 7 different currencies (Argentinean peso, inflation-adjusted Argentinean peso, US dollar, euro, yen, sterling pound and Swiss franc) and 8 jurisdictions (Argentina, United States, Great Britain, Japan, Germany, Italy, Spain and Switzerland).

proposal, a 75 per cent reduction was proposed on the amount of eligible debt. The issuing of three bonds called Par, quasi-Par and Discount was announced. It was established that the issuing date would be December 31, 2003 and that the bonds would accrue interests since then.²⁴ The offer included a coupon tied to GDP growth. It was announced that the Par and Discount bonds could be issued in inflation-adjusted pesos, US dollars, euros and yens. The quasi-Par bond -tailored to the needs of some domestic bondholders, pension funds in particular- was exclusively issued in inflation-adjusted pesos. The government announced that in order to guarantee the offer's financial consistency it would commit to maintain a 2.7 points of GDP primary surplus target during the first 5 years -when the service of the post default issued debt is concentrated- and stabilize the primary surplus at around 2.3 per cent of GDP from 2014 on. The bondholder's organizations rejected the proposal, claiming that the country should pay more than what was offered. By mid-2004 the financial analyses showed that the new offered debt value, including the coupons tied to the GDP-growth, was between 20 and 27 cents. This signified a present value reduction of about 73 per cent to 80 per cent, which was considered unacceptable by the market's participants. The discount rate used in these calculations was crucial. Most of the analysts considered reasonable to use the yield of assets of similar-risk emerging market countries, which at that moment was around 12 to 14 per cent.²⁵

By late 2004, the international capital markets' evolution unexpectedly started to play in favour of Argentina. The world liquidity stimulated the appetite for risk, which turned into an increasing demand for emerging markets debt and into a reduction of the developing countries' risk premium.²⁶ In this new context, the swap looked more attractive. The present value of the offered bonds calculated with the discount rate settled by the new financial conditions (for instance 10 per cent, the Brazilian debt yield) was between 30 and 35 cents. This present value

²⁴ This issuing date enabled interest payments immediately after the closing of the swap. This aimed at including a sweetener in the proposal to incentive the bondholders' participation.

²⁵ Brazil's debt was commonly used as a benchmark. Its yield then oscillated around 12 per cent. The debt of Ecuador, a country that had recently restructured its external liabilities, yielded a rate close to 14 per cent. High yields were consequence of the unfavorable funding conditions that the developing countries faced at that time. The JP Morgan EMBI+ index, which measures the emergent market risk weighted average, showed an average value of 502 basic points in May-June. In the same period Brazil's country risk-premium averaged 691 basic points.

²⁶ The EMBI+ index decreased to an average of 375 basic points in the last quarter of the year, whereas the Brazilian country risk-premium fell down to 417 basic points. The yield of Brazilian debt was about 9-10 per cent and the yield of Ecuador bonds was about 11-12 per cent.

represented a 65-70 per cent cut and was similar to the market price of the defaulted bonds.²⁷

The swap finally started on January 14, 2005. As minister Lavagna said, 'the moment has come for the markets to talk'. Six weeks later the restructuring operation was closed. On May 3, 2005, the government announced that the acceptance rate had reached 76.15 per cent of the debt in default. This meant that 62.3 billion dollars of the old bonds would be exchanged for about 35.3 billion dollars of new instruments plus the corresponding GDP growth-linked coupons. The maximum amount of the issuing would be 15 billion dollars in the case of the Par bonds, 8.33 billion dollars in the case of the quasi-Par bonds and about 11.9 billion dollars in the case of the Discount bonds. The government expressed satisfaction for the swap outcome. The operation signified the reduction in the public debt stock by about 67.3 billion dollars and attenuated the exposure of the public finances to the exchange risk, since around 44 per cent of the new bonds are denominated in local currency.

By the end of the same year the government decided to pay back ahead of schedule the whole outstanding debt to the IMF by a payment close to 10 billion dollars. We have made above several references to the role of the IMF at different moments, before and after the crisis. A closer look at the problematic relationships between the Argentinean government and the Fund is taken below, after examining the monetary and exchange rate policies.

The evolution of monetary and exchange rate policies

The weakening in the demand for local assets that would lead to the 2001-2002 crisis began in mid-1998. This process took place simultaneously with a persistent rise of the country risk premium. However, the divergent trends in the domestic financial market that triggered the collapse of the convertibility regime only started in October 2000, associated with the political turmoil caused by the Vice-President's resignation. The process followed simple dynamics. Devaluation expectations and the perception of a higher risk of default led the public to withdraw deposits and ran against the international reserves. There were no bankruptcy reports of failing banks because the central bank supported the liquidity

²⁷ Some financial analysts held the view that lower discount rates should be used, since after the restructuring, the Argentinean debt would turn out to be less risky than many of the countries' debts used as a benchmark for the calculation.

of the banking system. As we mentioned in the first section, despite several signals issued by the government aiming at changing the expectations, the intensification of this process could not be stopped. Thus, in the beginning of December 2001 restrictions on capital outflows together with the 'corralito' were established.

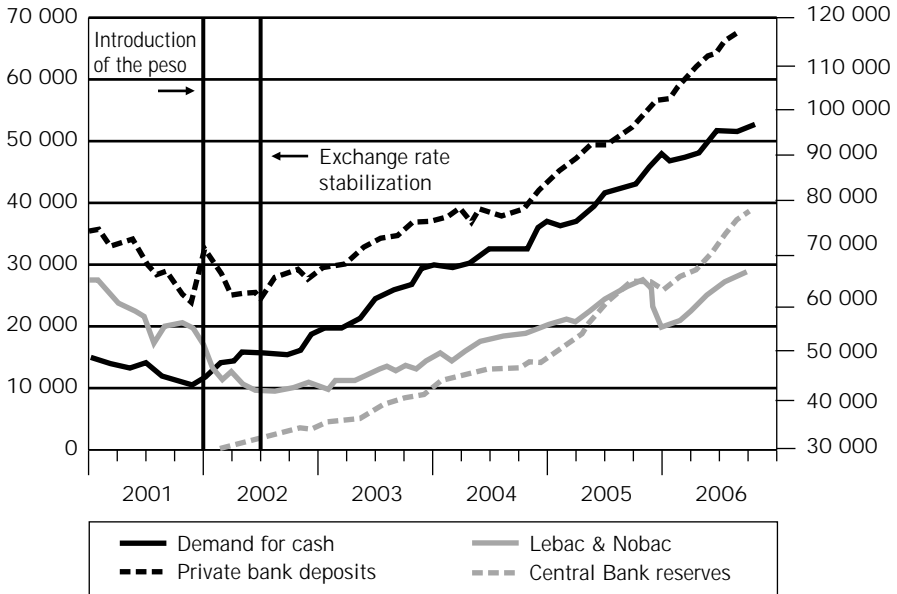
After the abandonment of the Convertibility regime, the government aimed to restrain the capital flight and stabilize the markets by introducing a dual exchange rate regime.

As we have explained above, the original idea was to use this scheme only temporarily, in order to stabilize the nominal exchange rate while the domestic prices absorbed the impact of the devaluation, and then pass to a floating rate regime. After the decision to unify the FX market and to let the peso to float, the price of the dollar skyrocketed, fed by self-fulfilling expectations. It should be noticed that this process developed in an illiquid environment because of the 'corralito' and the 'corralón'. However, the restriction on the withdrawal of cash from banks was not complete; some relaxations were introduced during January and February 2002. Besides, some additional liquidity was generated as a result of judicial decisions. In effect, a relevant portion of private savers, affected by the peso conversion and maturity extension of bank deposits, initiated judicial injunctions ('amparos'), asking for the reimbursement of their original bank deposits in dollars. Several judges ruled the peso conversion unconstitutional and demanded the banks to release the funds. Reimbursements of the funds originally deposited in dollars were made in pesos at the current exchange rate. With the pesos in their hands, people went to the FX market to demand dollars.

It should also be mentioned that an erratic monetary policy implemented in the first quarter of 2002 did not help to revert the above-mentioned critical trends in the financial system. It was especially questionable that the government delayed the launching of a domestic asset that could perform as a potential substitute for dollars. Given the distrust in banks and in the Treasury, the economic depression and the growing inflation, the international currency appeared as the only asset available to allocate financial assets. It was only two and half months after the devaluation that the central bank started to issue papers (the Lebac - "Letras del Banco Central") in order to supply a financial instrument that could compete with the dollar.

All the mentioned elements contributed to deepen the perverse dynamic of the financial variables during the first semester of 2002. The

Graph 8 – Demand for cash, central bank international reserves*, Lebac, and Private bank deposits 2001-2006 (right axis)
(In millions of pesos and dollars)



* In millions of dollars

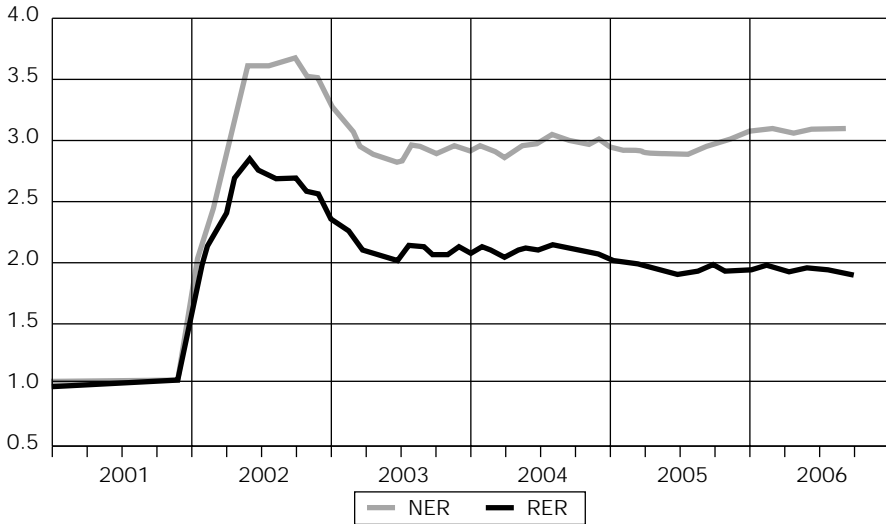
Source: Calculation by the authors based on data from the Central Bank

capital flight from domestic assets between March 2001 and mid-2002 is described in Graph 8. It can be seen that there is a significant fall in private bank deposits²⁸ and the nominal demand for cash is stagnant, while the international reserves are substantially dropping. These developments provide evidence for the substitution of local assets (cash and deposits) in exchange for external assets (international reserves).

The result of the asset substitution affected the FX market. The nominal (NER) and real exchange rate (RER) rose continuously along the first semester of 2002 (around 260 per cent and 180 per cent, respectively). Their paths are shown in Graph 9. The real exchange rate overshooting was so pronounced that in June 2002 its value was almost 50 per cent weaker than the 1980/2001-period average value, and 68 per cent weaker than the convertibility decade average.

²⁸ Graph 8 shows a 'jump' in the private bank deposit series in January 2002. It reflects the accounting effect of the 'pesoification' at 1.40 pesos per dollar of deposits issued in foreign currencies, previously valued at a \$/US\$ 1 rate. If we put this mere accounting effect aside, it is easy to see the drop in deposits.

Graph 9 – Bilateral nominal (NER) and real exchange rate (RER)* with the United States, 2001-2006 (In \$/US\$ and index 1 = December 2001)



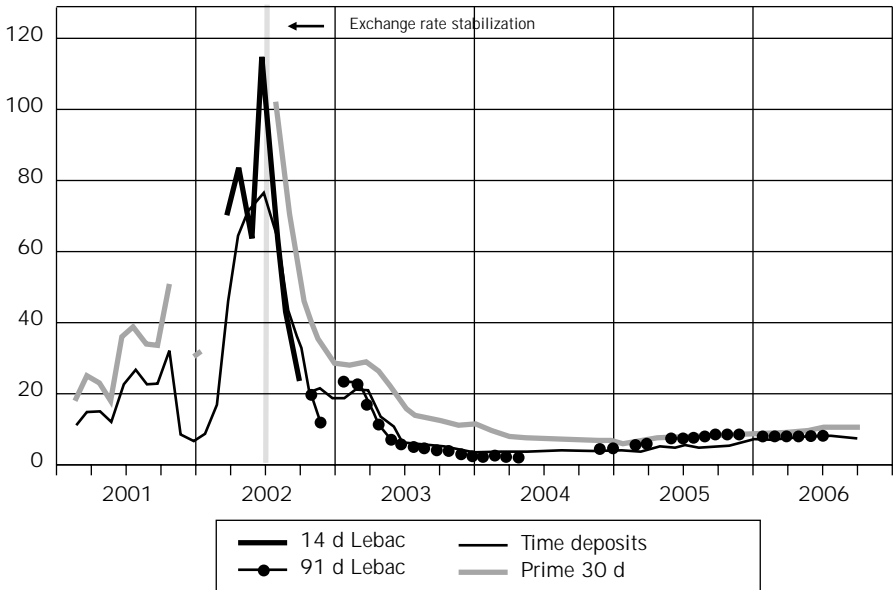
* Real exchange rate was calculated using US and Argentina Consumer Price Indexes

Source: Calculation by the authors, based on data from the Central Bank, INDEC and US Bureau of Labour Statistics

The critical trends began to revert in July 2002. The turning point was the FX market stabilization (see Graph 9). This was the result of several factors. Controls on foreign exchange transactions had been introduced in November 2001, before the convertibility collapse (including the obligation to surrender the proceeds from exports in the local FX market), and then tightened in March 2002. But it was only since early June 2002, after Roberto Lavagna took office as Minister of Economy, that the implementation of controls was strengthened and the interventions in the exchange market were reinforced, in order to conduct a systematic policy intended to stabilize the foreign exchange market. The decision that dollar export revenues surpassing US\$ 1 million had to be sold directly to the central bank was especially important in this regard²⁹. This became the main source of dollars for the monetary authority, which permitted to increase the volume of its interventions in the foreign exchange market.

²⁹ The limit for exports surrender then underwent several additional modifications, reducing the minimum to US\$ 200,000 in September 2002. With the normalization of the FX market, the authorities gradually started to raise the limit.

Graph 10 – Interest rates in pesos: Lebac (14 and 91 days), Time deposits (30 to 59 days) and Prime (30 days), 2001-2006
(Monthly average, in %)



Source: Calculation by the authors, based on data from the Central Bank

Limiting the peso outflow from the banks also helped to restrict the demand for foreign currency. In April 2002, the Congress approved the so-called “Ley Tapón” to ease the pressure resulting from the ‘amparos’. The law modified court procedures and stated that depositors would be allowed to access the funds only after the judicial process was concluded; in the meantime the funds had to be deposited in an escrow account (thus preserving the liquidity of the banking system). However, the law did not completely succeed in stopping the outflow from banks. It continued until July 2002, when the government issued a decree preventing reimbursement of deposits stipulated by the ‘amparos’ for 120 days.

Finally, the local financial market behaviour itself contributed to stop the bubble in the exchange rate. On the one hand, local interest rates skyrocketed (see Graph 10). In July 2002, the average time deposits interest rate reached a 76 per cent peak, and the interest rate of the 14-day Lebac reached almost 115 per cent. Thus local financial assets began to appear more attractive as substitutes for the dollar. On the other hand, as we mentioned above, the real price of the dollar reached very high and

'abnormal' levels in historical terms (i.e. the prices in dollars of domestic assets, non-tradable goods and salaries were perceived as abnormally low). In this context, once the authorities managed to stop the exchange rate bubble in July, the public rapidly changed expectations and the market started to show an appreciation trend.

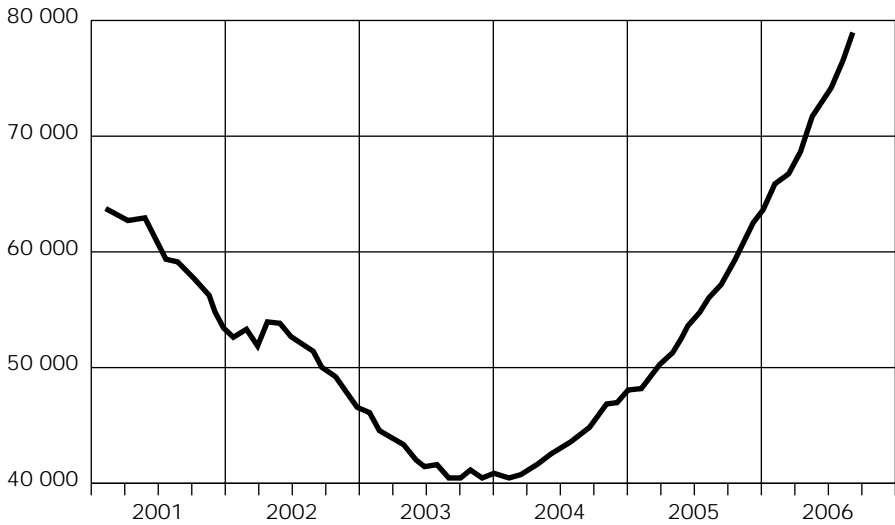
In the second half of 2002, a phase of monetary and financial variables normalization started. After reaching a peak of almost four pesos per dollar during the last days of June, the exchange rate began to experience a smooth nominal appreciation trend. Although the inflation rate was already low and decelerating, the rise in domestic prices contributed to the real appreciation. In that context, local assets became increasingly attractive. Bank deposits began to grow, as also did the demand for Lebac, local shares and the demand for cash (Graph 8). This portfolio substitution in favour of local assets resulted in a persistent drop in the interest rates (Graph 10).

The financial activity normalization dissipated disrupting expectations and thus allowed the above commented second-phase economic recovery, based on the domestic expenditure expansion. Interestingly, the recuperation of private expenditure during this phase took place without significant contribution from banks' credits. Even though, the recovery in private deposits allowed the recuperation of banks' liquidity, bank credit to private sector continued shrinking until late 2003 (see Graph 11).

In this context, domestic expenditure was mainly financed by private sector savings primarily held in cash. Graph 12 shows the increase in cash holdings since the fourth quarter of 2001. Both the monetary base/GDP ratio and the monetary base/total bank deposit ratio showed very high rates of growth and also relatively high levels in comparison to the convertibility period. Although the low interest rates on banks' deposits (and the tax on financial transactions) have contributed to that performance, this behaviour seems to be mainly a persistent consequence of the financial crisis.

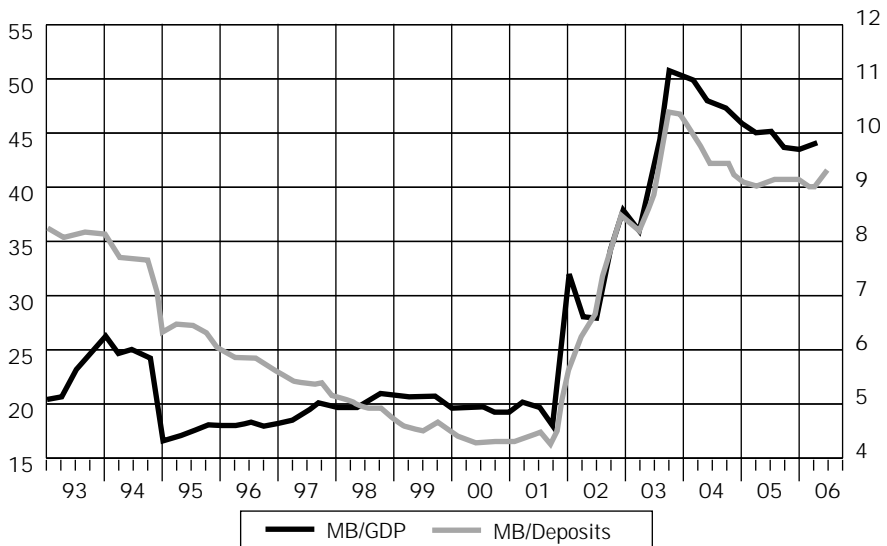
The nominal and real appreciation process stopped around mid-2003. This was mainly the result of a deliberate policy decision. The preservation of a stable and competitive real exchange rate (SCRER) was gaining relevance in the official policy orientation. Nestor Kirchner assumed as President in May 2003 and decided to maintain Lavagna as Minister of Economy. After a few months, both Kirchner and Lavagna started to make explicit reference to the importance of preserving a

Graph 11 – Bank credit to the private sector, 2001-2006
(In millions of pesos)



Source: Calculation by the authors, based on data from the Central Bank

Graph 12 – Monetary Base in relation to Total Bank Deposits and with GDP*, 1993-2006 (right axis) (In %)



* Seasonally adjusted

Source: Calculation by the authors, based on data from the Central Bank and Ministry of Economy

**Table 4 – Sources of variation of the monetary base
(Monthly average variation, in millions of pesos and dollars)**

	Operations with the Treasury	Assistance to Banks	Central Bank FX Intervention	Lebac	Others	Monetary Base Variation	Treasury FX intervention ⁽¹⁾
2002: 01 ⁽²⁾	124	1.426	-1.450	-216	522	406	n/a
2002: 02 ⁽³⁾	250	86	1.281	-270	327	1.674	n/a
2003	-52	-125	1.374	-420	32	809	28
2004	-543	-601	1.931	-323	19	483	112
2005	-353	-939	2.352	-836	-39	186	343

⁽¹⁾ In Millions of dollars

⁽²⁾ Calculated for the period February-June 2002

⁽³⁾ It is omitted a cancellation of a Banco Nación rediscount by the Treasury with assistance of the central bank in September 2002 for about \$ 3,500 millions

Source: Calculation by the authors, based on data from the Central Bank

SCRER in the official economic strategy. Although the announcements did not identify a specific policy target, the government — meaning both the central bank and the Treasury- operations in the FX market actually controlled the price of the dollar in a range between \$ 2.8 and \$ 3.10. This exchange rate policy has been conducted together with a monetary policy based on quantitative monetary targets, which started in 2003. From then on, targets have been announced at the beginning of every year throughout the central bank monetary programmes, in which the authorities commit themselves to maintain monetary aggregates within a certain range.

In 2003, the Central Bank started to face more openly the situation of dealing with two 'potential' conflicting objectives: the preservation of a competitive exchange rate by intervening in the FX market and at the same time the attainment of the strict monetary expansion targets announced in the monetary programme.

Table 4 shows the sources of variation of the monetary base. It can be seen that after a rapid growth in the monetary base during the second semester 2002, it follows a gradual deceleration in the following three years, particularly accentuated in 2005. The table also shows the increasing intervention in the FX market to preserve the exchange rate target.

The convergence of an increasing money creation caused by the interventions in the FX market and a decelerating monetary base growth was made possible through several mechanisms. Along 2003, the sterili-

zation operations implemented by the issuing of central bank letters (Lebac) and notes (Nobac) were especially relevant.

The need for financial sterilization increased during 2004 and 2005. The central bank could limit the issuing of Lebac and Nobac because other compensatory mechanisms began to operate. In the first place, as liquidity grew the banks started to service the debt incurred with central bank during the financial crisis. Hence, banks capital payments and especially the payment of interests operated as a source of contraction of the monetary base. In 2005, the central bank launched a programme allowing the acceleration of banks' debts amortizations, reinforcing this contractionary mechanism.

The Treasury also helped to absorb the 'excess' of monetary expansion caused by central bank's interventions in the FX market. While in 2002 a net flow of financing to the Treasury was observed, from the beginning of 2003 and especially in 2004, the transactions between the Treasury and the central bank operated as a source of contraction of the monetary base. Purchases of international reserves from the Central Bank with the proceeds of the fiscal surplus gave place to a monthly average monetary contraction of \$ 543 millions in 2005. The main purpose of these operations was to continue servicing of the debt with the multilateral financial institutions. However, the Treasury also intervened in the exchange market with the explicit purpose of preserving the real exchange rate level and to help management of the monetary base. The government, through the Banco Nación, intervened actively in the FX market. These operations started in 2002 and gradually expanded afterwards, thus becoming an important policy instrument. In effect, during 2005 the Treasury bought an average of 343 millions dollars per month.

In order to soften the appreciation pressures in the FX market and thus alleviate the central bank's intervention needs, controls on the capital account were introduced in June 2005. Basically, the new measures established that all capital inflows — excluding the issuing of new private and public debt, international trade financing and foreign direct investment — would be subject to a 30 per cent unremunerated reserve requirement for at least 365 days³⁰. This strategy is inspired by that applied in Chile in the 90's and attempts to reduce short-term capital inflows. However, the controls left open ways to avoid the reserve requirements. There has been no evidence of a reduction in the supply of dol-

³⁰ See Borzel (2005) for details.

lars in the FX market after the measures were implemented. For instance, capital inflows can easily circumvent the reserve requirement by operating through the stock exchange market (by buying domestic assets abroad and selling them in the local market). Local analysts believe that controls are ineffective and even the authorities do not reject the idea that they were introduced more as a signal of the official willingness to maintaining the SCRER strategy rather than as an effective control mechanism.

Argentina, the IMF and degrees of policy freedom

It is at first sight striking that the crisis and the massive default took place in a country that for a long time was considered an example of the Washington Consensus success. Almost until the end of the nineties, the IMF and most of the financial market's analysts considered the Argentinean experience as one of the success stories of macroeconomic policy and structural reforms in the financial globalization context.

The default in Argentina took place one year after the IMF gave considerable support to sustain the convertibility programme in crisis. In August 2001, four months before the default, the IMF expanded by 8 billion dollars the current standby programme and made a further disbursement. At that moment the crisis was at its peak. The devaluation and default were openly discussed (particularly in financial and academic settings in the United States) and there was a widespread opinion that the debt and the convertibility regime were not sustainable.

Assistance to Argentina was the last rescue package approved by the IMF during the period of the Democrats' administration in the United States. All of the circumstances converged to make it an exemplary case for the critics of the IMF administration.

The programme openly showed weak flanks susceptible to criticism from its very conception. It did not involve any substantial change in the current macroeconomic policy. In particular, the exchange rate regime was preserved. Besides the undeniable complexity and the difficulties that a regime change would have implicated, there was a complete lack of willingness to modify it among the authorities. Furthermore, from the IMF's perspective, the preservation of the regime was consistent with the systematic support of the exchange rate regime that the organization had provided throughout the nineties. The Argentinean currency board regime was usually mentioned as an example of a feasible "corner solution" for the exchange rate policy in an emerging market country (Fischer, 2001).

The programme aimed at recovering confidence through a commitment to fiscal austerity measures. The accomplishment of these measures was unlikely and its effects were doubtful. In the middle of the crisis, the recession and the liquidity crunch made, to a great extent, endogenous the fiscal account deterioration. It was implausible that the issuing of fiscal signals would be sufficient to stop the critical trends. In brief, from the moment the programme was approved, and even more so in August 2001-when the programme was extended-there was good reasons to think that the multilateral resources would end up funding payments to the private creditors and capital flights, without being able to stop the crisis and prevent the default. And that is exactly what happened. Certainly, some of the characteristics of the rescue packages that were at the centre of its criticisms were clearly observable in the support given to Argentina.

After the changes in the head of the organization that followed the Republican take over of the US administration, the relationship of the IMF to Argentina was used as a significant example of the problems with the previous management. The issue was important enough to carry out a special investigation by the Independent Evaluation Office (IEO, 2004).

The relationship between the IMF and Argentina after the devaluation and the default is marked by that story in a curious way. Actually, the IMF's support was absent precisely when it would have been more necessary: in the period after the devaluation, when efforts to stabilize the economy were at the centre of the economic policy.

Although the new management's criticisms regarding the support given by the IMF to the convertibility regime were justified, this did not provide any reason for not supporting the post-devaluation stabilization efforts. On the contrary, the self-criticism of the IMF implies an acknowledgement of its own part of the responsibility for the crisis. Therefore, the organization should have been even more committed to the stabilization attempts.

With new authorities in both the institution and the country, at least a cooperative attitude by the organization might have been expected. Yet, the institution's orientation was precisely the opposite. There was an extremely reticent attitude. The negotiations were centred on only one substantial matter: the Argentinean payments to the IMF.

The role the IMF played in the stabilization and the recovery of the economy in crisis was actually very negative. Mention should be made,

for example, of its positions regarding the exchange rate policy. In February 2002, in a context of high political fragility, the IMF staff exerted pressures for the modification of the exchange rate policy adopted by the country after the exit of the convertibility regime (it was a fixed exchange rate system with controls on the purchases of international currency). This system was explicitly set up as a transitory one, intended to stabilize the nominal exchange rate while the domestic prices absorbed the impact of the devaluation. A flexible exchange rate would be established later. The IMF demanded the immediate pure flotation of the exchange rate, threatening to forgo negotiations with Argentina while the exchange controls were in place. The measure demanded by the IMF was put into effect. It was followed by an abrupt rise in the price of the dollar, as it was clearly predictable, and a fast acceleration of inflation. The country got nothing in exchange for that “prior action.”

Soon afterwards, the recently designated Minister Lavagna implemented a new stabilization programme that preserved the flotation but introduced interventions in the exchange market, and reinforced some exchange controls aiming at stabilizing the exchange rate. This policy also faced the opposition of the IMF, though in this situation the demands of the institution were not satisfied. The interventions and the control measures that were implemented, in spite of the opposition of the Fund's staff, turned out to be crucial for exchange rate and inflation stabilization.

Another example of the negative role of the IMF is the orientation that it tried to impose on bank crisis management. Since the Minister Lavagna took over, the government looked for a gradual exit from the crisis, favouring the generation of voluntary options for the savers and avoiding new shocks to the system. Confronting this orientation, IMF staff promoted heroic “solutions” with uncertain outcomes (banks liquidations, the restructuring of the public banks, etc.). This issue derived into an open conflict between the government and the Fund's staff that resulted in the creation of an arbitrating commission mainly composed of former presidents of European national central banks.

The government did not satisfy the main demands of the IMF regarding the management of the banking crisis. It persisted in its orientation, which ended up showing success when the exchange market stabilized and an incipient recovery of the economic activity helped to induce greater confidence among savers. The crisis could be managed without ulterior disruptions in a context of gradual growth in bank deposits.

The two mentioned examples indicate that the Fund's staff operated in that phase with the diagnosis that the exchange market could not be stabilized, that a hyperinflationary process was unavoidable and that it would be impossible to re-establish some degree of financial intermediation in domestic currency in the near future. The staff publicly acknowledged their diagnostic mistake later on (see below). It is clear that had the economic policy followed the orientation that the IMF wanted, the evolution of the economy would have been more in line with what the IMF expected. The implementation of the measures promoted by the IMF would have transformed its implicit diagnosis in a self-fulfilling prophecy.

The IMF sustained a negative attitude towards Argentina for a long time. In the second semester of 2002, the exchange market and the prices stabilized, and the data of the activity level and the external sector performance started to show positive outcomes. IMF staff did not waste any occasion to make public its disbelief regarding the sustainability of the stabilization and the recovery of the activity and employment levels. It was not until May 2003 that the Deputy Managing Director publicly confessed to having failed in her diagnosis and manifested having been surprised by the quick economic recovery and by the fact that there was no hyperinflation³¹.

The IMF continuously maintained its opposition to the Central Bank interventions in the exchange market, also after mid-2002, when the market started to show excess supply of international currency and the interventions attempted to avoid the fall in the price of the dollar. Although the agreement signed in 2002 did not preclude the Central Bank interventions in the exchange market, it included an extremely restrictive monetary target. The monetary base had to be maintained constant in nominal terms from the beginning to the end of 2003. Coming from a highly demonetized situation, with the economy showing a rapid recovery in the activity level, the accomplishment of the hard monetary target would have imposed serious difficulties to the normalization process. In early 2003 the Central Bank had not yet started to implement substantial sterilization operations and its interventions in the exchange market were still timid and hesitant. The Central Bank authorities felt themselves trapped in a conflict between the preservation of the exchange

³¹ Public comments by Anne Krueger, Deputy Managing Director of the IMF on May 2003. *Diario Clarín* May 7, 2003.

rate and the accomplishment of the monetary target. Finally, the monetary target was renegotiated in mid-2003 allowing a higher expansion of the monetary base. The example shows that the IMF orientation has always had practical consequences in the formulation of the economic policy and that the authorities permanently had to confront the staff in order to defend their diagnosis and preserve their degrees of freedom.

The 2002 and 2003 agreements were signed in that high conflictive context in the relationship between the Argentinean government and the IMF. Given the attitude of the latter, political influences were crucial, especially the favourable position of the United States. In September 2003 a three-year agreement was signed, intended to refinance the amortizations of the debt with the institution. The refunding mechanism consisted in crediting new funds for the equivalent amount of the capital amortizations. This “fresh funding” was subjected to the usual terms of conditionality.

The terms of conditionality were established for the first year. The terms corresponding to the following two years were left to be defined in future negotiations. The most important of the committed targets was the magnitude of the consolidated fiscal primary surplus. A 3 per cent of GDP was determined only for the first year of the agreement because the government resisted the pressure to commit increasing targets for the following years. Other important targets included in the agreement were the redefinition of concessionary contracts of public services and the establishment of new regulations on public utilities (privatized in the nineties), the establishment of new measures tending to reinforce the financial system and the approval of a law on fiscal revenue distribution between the Nation and the provincial governments. Conditionality also included a clause under which the country committed to good faith in the treatment of private external creditors. The ambiguity of the term left the IMF a great margin of discretion in the evaluation of the accomplishment of this clause.

One year later, Argentina had comfortably fulfilled its quantitative fiscal and monetary targets, but not the qualitative conditions. Probably, the most significant target not fulfilled was the finalization of the renegotiation of the contracts and the establishment of a new regulatory frame for the privatized public utilities.

By the time the IMF had to evaluate the fulfilment of the conditionality clauses, the country was presenting the debt restructuring pro-

posal and organizing the swap. The relationship between Argentina and the Fund then reached an impasse, the foundations of which we comment next.

The IMF could have terminated the agreement, justifying the decision by the non-fulfilment of the qualitative targets or by resolving that Argentina did not negotiate in good faith with the creditors. That would have signified a serious negative shock for a country in the middle of the debt restructuring process. Nevertheless, in those circumstances, the IMF would have also placed itself in a difficult position. Argentina still was one of the big debtors of the institution and there was a chance that the country would stop giving seniority to the multilateral debt and suspend payments. This would have generated a complex international problem. Furthermore, the interpretation that the IMF was interfering in the country's negotiation with the bondholders could have not been avoided, in contradiction with the doctrine saying that these matters should be solved by the parties involved without the IMF's intervention-this argument was particularly emphasized by the United States.

The impasse was overcome through the suspension of the programme. Following a request from Argentina, the programme was suspended until the beginning of 2005. Since the suspension Argentina paid to the Fund all the interests and the amortizations that could not technically be postponed. They also asked for and obtained the postponement of the payments that did have this possibility. Moreover, some minor capital payments were made which postponement could have been required. The Argentinean government did so to avoid the board's discussion of the Argentinean case before the swap was finished. In the period 2002-2004 the country made net capital payments to the IMF for more than 2.1 billion dollars, together with another 1.9 billion dollars in interest.

After the debt swap, Argentina resumed the negotiations with the IMF with the advantage of a high proportion of acceptance of the swap (76.15 per cent). The figure was not only relevant because it legitimized the operation. New actors and elements emerged after the episode such as the new bonds' quotations and the voices of the financial markets. After the swap Argentina brought to its side an important number of bondholders interested in a cooperative attitude of the IMF contributing to improve the new bonds' market valuation.

However, the IMF faced the Argentinean requirement from the point of view of its institutional logic. In this logic, the refinancing of the

country's debt involved the approval of new loans. Actually, the purpose of these loans would have been to provide support to a fiscal financial programme based on an autonomous strategic decision of the Argentinean government in which the IMF had not had any participation. Consequently, the acceptance of the Argentinean demand would have meant that the IMF was forced to accept an important innovation.

The conflicts involved in the treatment of the Argentinean case were exacerbated by the special circumstances that the institution was going through.

The role that the IMF played in the Argentinean sovereign debt restructuring was at the antipodes of the crucial role delineated in the initiative proposed by Anne Krueger at the beginning of her mandate.

From the beginning of the eighties, the IMF actively participated in the restructurings of sovereign debts with the private sector. Regarding this tradition, Ms. Krueger's Sovereign Debt Restructuring Mechanism (SDRM) initiative seems to have been an attempt to delineate more precisely, formalize and strengthen this function of the IMF. After Wall Street and the United States government rejected the SDRM initiative, the role of the institution in cases of sovereign debt default remained undefined. The US government rejection not only frustrated the IMF initiative but also ended up questioning the very participation of the IMF and the commitment of multilateral funds in the restructuring of debts with the private sector.

Nowadays, the functions of the IMF in the international financial system are probably more undefined than ever before and the institution lacks precise orientation. No new function replaced the role of "financial globalization central bank" to which its performance got close in the nineties. On the other hand, the burial of the SDRM initiative was a hard negative shock to the aspiration of a new role for the institution, and nothing came in replacement.

From the point of view of its objectives as a multilateral financial institution, there is no doubt that the IMF should have given positive answers to the country's demands and contribute to its normalization. However, from the point of view of the institution as a bureaucratic organization with its own interests, the agreement with Argentina implied the formal acknowledgement of a much less important role than the one played in the past.

Thus, the difficult negotiations that the country and the IMF maintained throughout the rest of 2005, after the debt swap, did not arrive to a new agreement. The government resolved to keep paying all the interests and the amortizations that could not technically be postponed during that year, to finally adopt the decision to pay back ahead of schedule all obligations to the institution, which was done at the beginning of 2006.

The preservation of a competitive real exchange rate

As we have just explained, since mid-2002 — with a clearer definition from mid-2003 — Argentina has been implementing a managed floating exchange rate regime. We will focus now on this aspect of the current policy setting.

It has been pointed out above that the regime includes a *de facto* target of preserving a competitive real exchange rate. Although the managed floating is implemented by the majority of developing countries adopting floating exchange regimes, it has not been well documented and analyzed (Bofinger and Wollmerhäuser, 2003; Canales-Kriljenko, 2003). In spite of that lack of analysis and debate, the managed floating regime is frequently criticized and objected from orthodox theoretical perspectives.

Before considering the most important orthodox objections, it is worth mentioning in the first place that a relatively stable real exchange rate target does not attract too much criticism by itself. Few people in both the mainstream and heterodox thinking deny the beneficial aspects of stable and predictable relative prices and the positive development role of competitive exchange rates (Frenkel, 2004b; Frenkel and Taylor, 2005). In some cases, welfare arguments against public intervention in the FX market are raised. But the optimality of the free market determination of the exchange rate and the argument that the public sector has no informational advantage over the private sector are not very appealing ideas in the specialized discussion about exchange rate regimes and policies. The apparent volatility of capital flows and the instability and unpredictability of free-floating exchange rates greatly lessen the relevance of those ideas (Frankel and Rose, 1995). Moreover, the free-floating exchange rate indeterminacy and unpredictability is precisely the deeper foundation of both the need for managing the exchange rate and the government ability to do it (Blecker, 2005, Taylor, 2004, chapter 10). This is particularly true in countries in which the real exchange rate plays a crucial role in the economic performance.

Most of the orthodox objections are based on the so-called trilemma of the economy open to capital flows. It says that it is impossible for a country to simultaneously maintain free capital flows, active monetary policy and the ability to control the exchange rate. One of these features must necessarily be given up. In other words, the trilemma says that in an economy open to capital flows it is impossible for the authorities to simultaneously control the exchange rate and the interest rate (or the monetary base).

As was presented in the Argentine debate, one way to express the orthodox argument is the following. Targeting the exchange rate implies a central bank intervention in the foreign exchange market. In doing so, it is argued, the central bank loses its ability to control the money supplies. So, targeting the exchange rate and controlling the money supply can be simultaneously pursued only if capital flows are regulated (the trilemma). However, the regulation of capital flows is undesirable and probably ineffective, because the private sector innovative capacity is greater than the public sector regulatory ability. The orthodox conclusion is that central banks have to avoid intervening in the exchange market.

Another way to reach the same conclusion is by focusing the argument on controlling inflation (as was also presented in the Argentine debate). If the interventions in the exchange market target the real exchange rate (instead of the nominal exchange rate), no nominal anchor remains for the public to configure inflationary expectations. Since the central bank cannot control the money supply, the inflation rate is completely out of control.

The most important point that has to be made about the trilemma is that it is invalid in some contexts and, consequently, it is false as a general theorem characterizing the performance of economies open to capital flows. For instance, in a balance of payments surplus setting, the Central Bank can control the exchange rate by purchasing all the excess supply of international currency in the exchange market and sterilize the monetary effect of that intervention through the issuing of Central Bank bonds in the monetary market, without changing the local interest rate. The Central Bank has two available instruments to perform its two targets: the intervention in the exchange market to control the exchange rate and the intervention in the money market to control the interest rate.

The excess supply of international currency, at the exchange rate targeted by the Central Bank, implies an excess demand for domestic

assets at the prevailing domestic interest rate. The fully sterilized intervention in the exchange market can be imagined as a policy implemented in two steps. In the first step, before sterilization, the Central Bank intervention generates a monetary base expansion. The resulting situation would show a higher amount of monetary base, the same amount of domestic bonds and an interest rate lower than the initial one. In the second step, the full sterilization compensates for the change in the private portfolio that took place in the first step. The Central Bank absorbs the increment in the monetary base and issues an amount of domestic assets equal to the initial excess demand for domestic assets (the excess supply of international currency) turning the domestic interest rate to its previous level (Bofinger and Wollmerhäuser, 2003).

The crucial element in the above-mentioned Central Bank ability to simultaneously control the exchange rate and the interest rate is the existence of an excess supply of international currency at the targeted exchange rate. This is the setting that makes the trilemma invalid. It seems that this simple idea is not generally acknowledged because the literature discussing monetary autonomy and exchange regimes rarely considers situations of excess supply of international currency because it is mostly focused on balance of payments deficit situations (see, for instance, Canales-Kriljenko, 2003).

Certainly, in balance of payments deficit contexts, the trilemma is generally valid. In conditions of excess demand for international currency even powerful central banks have a limited capacity of intervention in the exchange market. This limit is determined by the availability of international reserves. Consequently, even powerful central banks cannot simultaneously control the exchange rate and the interest rate in contexts of excess demand for international currency. But there is no symmetry between balance of payments deficit and surplus situations. In the first case the trilemma is valid while it is invalid in the second case.

Can the fully sterilized exchange market interventions policy be sustained in the long run? To be sustainable, the mentioned policy has to fulfil a consistency condition: the net liabilities of the Central Bank should not follow an explosive trend. The time-consistency of the policy depends on the magnitudes of the international and the domestic interest rates and on the rate of variation of the nominal exchange rate. Taken as given the international interest rate and the trend of the nominal exchange rate, the time-consistency condition depends on the domestic interest rate. The Central Banks enjoys autonomy to determine the

domestic interest rate, but in order to be sustainable the policy must determine domestic interest rates lower than a certain upper limit.

The sterilization cost is a flow proportional to the difference between the domestic interest rate, on the one hand, and the international interest rate plus the rate of growth of the nominal exchange rate, on the other hand. The fulfilment of the time-consistency condition does not require the sterilization cost to be nil. The condition stipulates that the cumulative sterilization cost should be bounded and manageable. The crucial point is that the policy is sustainable only if the domestic interest rates set by the Central Bank are “moderate” (in the mentioned sense).

The Argentine Central Bank implements a “*de facto*” exchange and monetary regime that is different from its “*de jure*” regime. With regard to the interventions in the exchange market, the Central Bank “*de jure*” target is the accumulation of international reserves. Although the preservation of a competitive real exchange rate is a central element of the government economic policy, the Central Bank does not make any reference to the existence of a real exchange rate target, neither in the short run or in the long run. However, in the recent years the interventions in the exchange market have maintained a more or less stable multilateral exchange rate. The Central Bank implements a “*de facto*” managed floating policy intended to maintain a competitive real exchange rate. Simultaneously, the Central Bank has preserved its control of the monetary variables by implementing different forms of sterilization. The evolution and prospects of the Central Bank balance sheet does not show sustainability problems regarding the sterilization policy. On the other hand, the current account surplus and the robustness of the fiscal accounts do not question the sustainability of the exchange and monetary policies. Consequently, the financial investors, who normally give more importance to the implemented policies than to the formal announcements, have “disconnected” their exchange rate expectations from the monetary policy. The financial investors believe that the Central Bank can control the exchange rate without losing control on the monetary variables.

As from 2005, the “*de jure*” monetary policy consists in targeting an annual rate of expansion of a monetary aggregate (M2). More precisely, before the beginning of the year a relatively broad interval of M2 rates of growth, with a maximum and a minimum, is announced as the target for the next year. The short run, interest rate is not a policy instrument in the “*de jure*” regime. However, the Central Bank actually controls the inter-

est rate throughout a number of intervention instruments in the monetary market.

The duality of “*de jure*” and “*de facto*” regimes has different consequences for the exchange and monetary policies. The reserves accumulation “*de jure*” target does not conflict with the “*de facto*” exchange rate target. So, the duality does not generate problems in this policy area. (Although for development fostering objectives it would be better that the government and the Central Bank had an explicit and unique orientation about the long run targeting of a competitive exchange rate). But in the monetary policy area the duality of regimes could be problematic. As was mentioned above, the sustainability of the sterilization policy depends on the domestic interest rate. The policy is sustainable if the interest rate is lower than a certain upper limit. With the “*de jure*” commitment of a M2 intermediate target the monetary policy is over determined and a conflict could emerge between the accomplishment of the monetary target and the sterilization policy. This is so because the badly predictable behaviour of the public’s demand for money could push the short run interest rate to a level higher than the upper limit that makes sterilization policy sustainable. This conflict has not emerged so far and will not necessarily emerge in the future if broad M2 expansion targets do not constrain the management of the domestic interest rate, as it has been the case up to now.

4. The evolution of employment and unemployment in the recovery phase

In 2002, with economic reactivation, employment began to recover. In this section³² we will first of all analyze the evolution of full-time employment since the second half of 2002. We are interested in obtaining a long-term view which will allow us to examine changes over time and make comparisons with the period we analyzed in section 3, when the convertibility regime was in force. A difficulty in this respect, however, is that the twice-yearly permanent household survey (PHS) was discontinued in the first half of 2003 and replaced with an ongoing PHS, which gives quarterly figures. The results of the ongoing PHS, by quarters, are available as from the first quarter of 2003, but the employment

³² Both the analysis of the recent evolution of employment and unemployment, in the present section, and that of wages (further below) are based on Damill and Frenkel (2003) and Frenkel (2005).

rates of the two surveys are not directly comparable because of changes in the methodology used.

In order to solve this problem, we proceeded as follows. We calculated half-yearly averages of the employment rates of the ongoing PHS, so as to have half-yearly data with a frequency similar to that of the PHS in the past. Moreover, instead of working with the levels of the employment rate, we calculated a long series of half-yearly differences (i.e., the difference between one half-year and the preceding one). The coupling together of the series of differences between half-year periods from the half-yearly surveys and the data from the ongoing surveys was effected by taking advantage of the fact that in the case of the first half of 2003 we have observations made in both surveys. This makes it possible to calculate all the differences with half-yearly data from a single PHS: the twice-yearly one up to the first half of 2003 and the ongoing one as from the second half of that year. Although the half-yearly differences thus calculated are not strictly homogeneous, the error arising from this procedure may be assumed to be very slight.

Let us call the variable that interests us D (FEMPL). This is the difference in the full-time employment rate, without social plans, between one half-year and the preceding one. The exclusion of social plans when measuring FEMPL is important, because the introduction of the Plan for Heads of Households led to a considerable increase in the voluntary underemployment rate.³³ If the full-time employment rate did not exclude the social plans, it would register an increase that had nothing to do with the economic processes. The full-time employment rate considered by us therefore excludes those working under social plans. The variable D (FEMPL) is measured in percentage points of the total urban population. The tables below show the evolution of this variable from the second half of 2002 up to the first half of 2006, together with the de-seasonalized half-yearly growth rates of GDP which we have called $DL(GDP)$. $DL(EMPL)$ stands for the rate of growth of the estimated number of full-time occupations, and $ELAST$ refers to the output elasticity of full-time employment in every period.

Table 5 shows that in the eight half-years considered, the GDP registered a cumulative increase of 37.3 per cent, while the full-time employ-

³³ We refer to the Plan for Heads of Households set up in 2002 to relieve the serious social situation generated by the worsening of the crisis. Under this Plan, allowances of 150 pesos are given to heads of households with children, in return for a certain amount of work.

Table 5 – Argentina: Variation in full-time employment rate, growth rate of full-time employment, GDP growth rate and output elasticity of full-time employment between one half-year and the similar preceding period, without social plans

Half-year	D(FTEMPL)	DL(GDP)*100	DL(EMPL)*100	ELAST
2002:2	0.68	1.18	3.14	2.68
2003:1	1.06	5.19	4.51	0.85
2003:2	1.86	5.11	8.23	1.61
2004:1	0.96	3.84	3.74	0.97
2004:2	1.38	4.51	4.20	0.93
2005:1	0.50	4.15	2.08	0.50
2005:2	1.51	4.75	4.80	1.01
2006:1	0.54	3.53	1.96	0.56

Note 1: Variations and growth rates are calculated between one half-year and the similar preceding period.

Note 2: Employment generated by social plans is not included

Source: Authors' elaboration based on INDEC

Table 6 – Argentina: Half-yearly variations in unemployment and full-time employment rates (percentages of the population)

Half-year	D(U)	D(FTEMPL)
2003:1	-0.94	1.06
2003:2	-1.67	1.86
2004:1	-0.35	0.96
2004:2	-0.88	1.38
2005:1	-0.13	0.50
2005:2	-0.79	1.51
2006:1	0.16	0.54

Source: Authors' elaboration based on INDEC

ment rate went up by 8.5 percentage points of the urban population. The increase in the number of full-time occupations in the same period amounted to 37,6 per cent, very close to GDP growth, making the average output elasticity of full time-employment equal to one for the period as a whole. However, as can be seen in the right column in the table, that elasticity was considerably higher at the beginning of the period, and shows a moderate declining trend, as could be expected as a result of the gradual convergence of the economy to a new intensity of labour utilization.

The increases in full-time employment (without social plans) accounted for the whole of the reductions observed in unemployment rates since 2003. This may be seen in Table 6, which shows the half-yearly variations in unemployment and full-time employment. In order to facilitate comparison, the variations in unemployment $D(U)$ are expressed as percentages of the total urban population.

In all the half-year periods, the increases in the full-time employment rate without social plans exceeded the falls in unemployment in absolute values. For the period as a whole, the decline in unemployment reached 4.6 percentage points of the population, while the rise in full-time employment amounted to 7.8 percentage points. The difference corresponds to a fall in underemployment and to the incorporation to employment of people that were not active in previous periods.

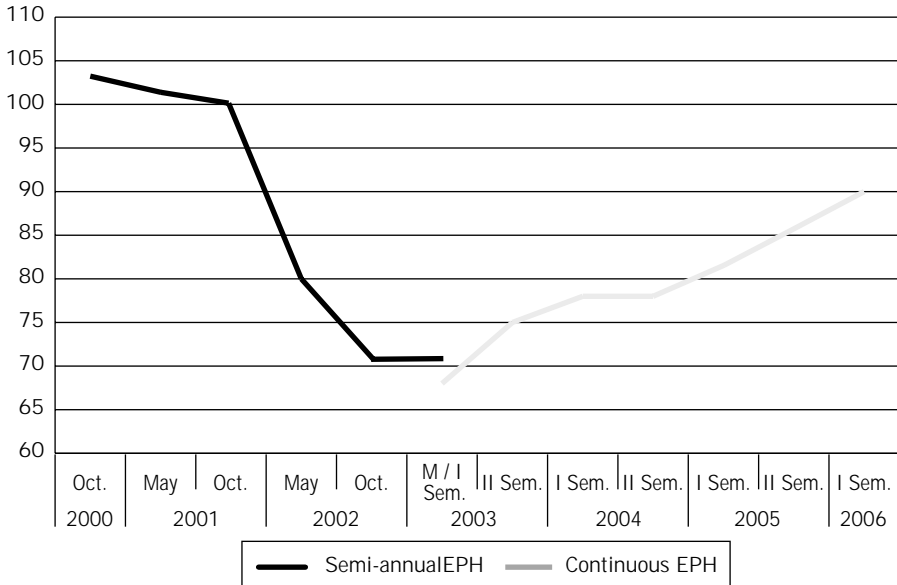
In short, since 2003 the contractions observed in unemployment are explained by the increases in the full-time employment rate without social plans; these plans were present, as a relatively stable background to the situation, throughout the period in question. Consequently, the changes in labour market conditions as from that year can be represented by the variations in unemployment rates and also in the full-time employment rates.

The evolution of the labour market variables in the long run, from the eighties to the present, can be seen in Graph 5. Although the figures are not strictly comparable, the graph shows that the full-time employment rate has recuperated all the fall experienced during the Convertibility regime period and is similar the early eighties. On the other hand, the current total employment rate (without social plans) is the highest in the series.

Labour incomes and their distribution

In parallel to the evolution of employment, three phases can be identified in the evolution of real wages. There was a first phase after the devaluation in which real wages fell; a second phase of stabilization and a third phase of recovery and growth that started at the beginning of 2003. In effect, the increase in domestic prices after the devaluation had a direct negative effect on the purchasing power of wages. Between October 2001 and October 2002 real wages (from the Permanent Household Survey -EPH) fell around 30 per cent, although more than two thirds of the fall was verified in the first semester after the exit from the Convert-

Graph 13 – Real Income from main occupation 28 urban centers, excluding employment plans (Index Oct 01=100)



Source: Authors' elaboration based on data from EPH (INDEC)

ibility. After this strong reduction, since October 2002 nominal labour incomes started to grow at a similar pace than prices, hence the figure of May 2003 was similar to the figure of October 2002 (Graph 13).³⁴

As from 2003, both the greater dynamism of the demand for labour and the price stability allowed an increase in the real incomes of employed population after the long period of continuous fall. In the first year of recovery -between the first semester of 2003 and the same period of 2004-, real wages grew 14 per cent, excluding from the calculation the beneficiaries of employment plans. Later on, the purchasing power of wages kept on growing: it rose 11 per cent between the first half of 2005 and the same period of 2006. Throughout the whole period, the average real incomes of employed population increased 31 per cent (Table 7).

³⁴ In 2003, as was already mentioned, there was a methodological change in the Permanent Household Survey (EPH): since then, the semi-annual EPH (whose last wave was sampled in May 2003) was replaced by a continuous EPH (see www.indec.mecon.gov.ar). This causes a discontinuity in the series that the change in methodology does not allow to match. In all cases, the figures strictly belong to the scope of the survey comprised by 28 urban centres.

However, given the strong previous reduction at the beginning of 2006, real wages were, on average, approximately 10 per cent lower than those at the end of the Convertibility (Graph 13).

Real incomes increased for all the groups of workers defined according to their occupational category,³⁵ although with different intensities (Table 7). In particular, between 2003 and 2006 there was a 33 per cent increase in real wages of unregistered wage earners in the private sector, whereas the increase for registered wage earners in the same sector was significantly lower (23 per cent). On the other hand, the real income of non-wage earners (self-employed plus employers) rose approximately 43 per cent. The fact that the largest increase was observed in those jobs not covered by social security constitutes a novel phenomenon since in the previous periods of wage recovery the latter had taken place fundamentally among registered wage earners.

Moreover, another important characteristic of the trajectory of wages has been the different evolution according to the educational level of workers. In particular, there has been a relative improvement in incomes of the less educated throughout this period: the real income of workers with incomplete secondary school or less increased 37 per cent as opposed to a 24 per cent rise for those with complete university (Table 8).

As a result, when both dimensions are considered -occupational category and educational level- it can be observed that there has been a reduction in the wage gap between the extremes of the distribution that has contributed to the reduction in inequality among workers.

One of the factors that have contributed to this process has been the significant incomes policy implemented by the National Government since mid-2002 through lump-sum rises and increments in the minimum wage. These measures have a greater impact on lower income groups. In effect, the National Government established by decree an increase of \$100 for the private sector in the second semester of 2002 (without contribution to the social security), and gradually rose it up to \$200 at the end of 2003. As from July of that year, those amounts started to contribute to the social security system. In 2004, there were further increases but of smaller magnitude. At the same time, the minimum wage was

³⁵ Wage earners registered in the Social Security System, non-registered wage earners and non-wage earners.

Table 7 – Evolution of the real income from the main occupation, according to occupational category 28 urban centres. Excludes employment plans

	I Sem 2003	II Sem 2003	I Sem 2004	II Sem 2004	I Sem 2005	II Sem 2005	I Sem 2006	Variación I Sem 06- I Sem 03
Total employment	722	783	825	819	856	900	947	31%
Total wage earners	730	783	819	809	840	887	929	27%
Registered	961	1014	1059	1032	1077	1142	1193	24%
Non-Registered	413	460	476	497	507	519	529	28%
Private Sector wage earners	666	736	769	758	793	817	865	30%
Registered	962	1037	1081	1037	1091	1125	1188	23%
Non-Registered	386	448	452	484	490	495	512	33%
Non-wage earners	699	790	840	847	901	937	1000	43%
Employer	1685	1938	1800	1719	2051	2014	2085	24%
Self-employed	572	613	654	670	684	714	777	36%

Source: Authors' elaboration based on data from EPH (INDEC)

Table 8 – Evolution of real income from the main occupation, according to educational level 28 urban centers. Excludes employment plans

	I Sem 2003	II Sem 2003	I Sem 2004	II Sem 2004	I Sem 2005	II Sem 2005	I Sem 2006	Variación I Sem 06- I Sem 03
Total employed	722	783	825	819	856	900	947	31%
Incompl. secondary school or less	485	521	562	558	592	602	663	37%
Compl. second school – Incompl. university	775	812	850	854	877	934	977	26%
Complete university	1290	1382	1471	1414	1501	1636	1601	24%

Source: Authors' elaboration based on data from EPH (INDEC)

increased successively from \$200 — current until June 2003 — to \$450 in September 2004. In 2005, it was raised up to \$630, and in 2006 a further increase allowed to raise the minimum wage to \$800. For workers in the National Public Sector an increase of \$100 (without contribution to the social security) was established since June 2004 for those who earned wages lower than \$1,000; and since January 2005, an increase of \$100 was established for workers with wages lower than \$1,250. Further increases were established in 2005: 10 per cent since June and 9 per cent since August.

Even though the unregistered wage earners are not covered by labour legislation, it is often argued (Frenkel 2004a) that the wages earned by those workers that are covered by social security — or, at least their variations — have a certain impact on the wages paid to the former group of workers. If this is so, and given the lower average value of wages of unregistered workers, the non-proportional increases must have had a greater impact on them.

Due to the generalized fall of real wages along the semester that followed the exit from the Convertibility, the Gini index remained practically unchanged. After a small increase in inequality between May and October 2002, the trend towards higher concentration of incomes started to reverse (Graph 14)³⁶. The new trend towards less concentration continues up to present and contrasts with the process experienced throughout the nineties. In effect, the Gini index of income from main occupation fell 8 per cent between the first semester of 2003 and the first semester of 2006 passing from 0.472 to 0.435.³⁷

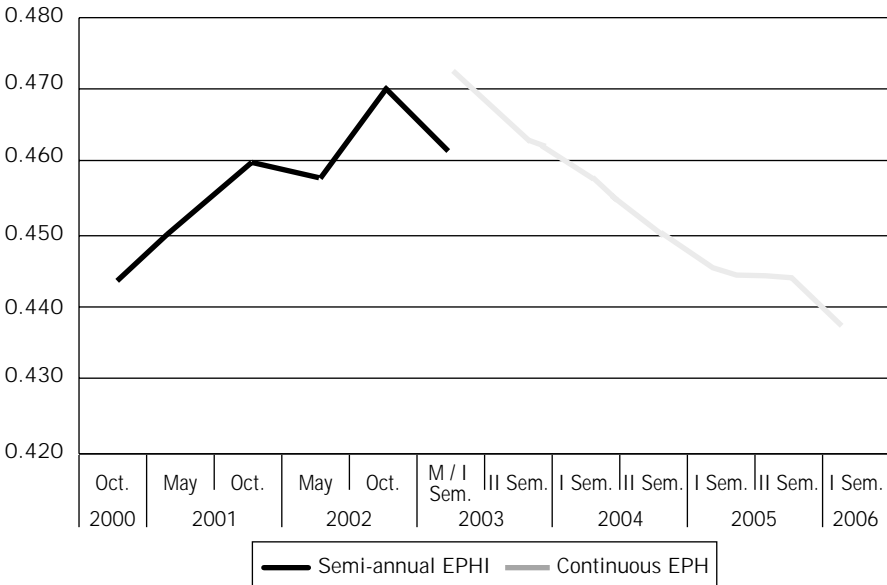
The change of trend in the distribution of labour incomes can be seen in greater detail in Graph 15. It compares the variations in real incomes according to percentiles of income from main occupation in three different periods: the last phase of Convertibility (May 1998-Oct. 2001), the first year after the change of regime (Oct. 2001-Oct. 2002) and the period of recovery (I Sem. 2003-II Sem. 2006).

As can be seen in the graph, the deterioration of labour market conditions in the final phase of the convertibility regime led to a fall in real

³⁶ The Continuous EPH has improved the data collection regarding precarious activities, most of which generate incomes that are lower than average incomes of employed workers. This is one of the factors that explain why the inequality indicators of the continuous EPH in the first semester of 2003 are higher than the corresponding indicators in May 2003 of the semi-annual EPH.

³⁷ The reduction verified throughout this whole period is statistically significant with a 95% level of confidence.

Graph 14 – Gini index of income from main occupation 28 urban centers. Excludes employment plans



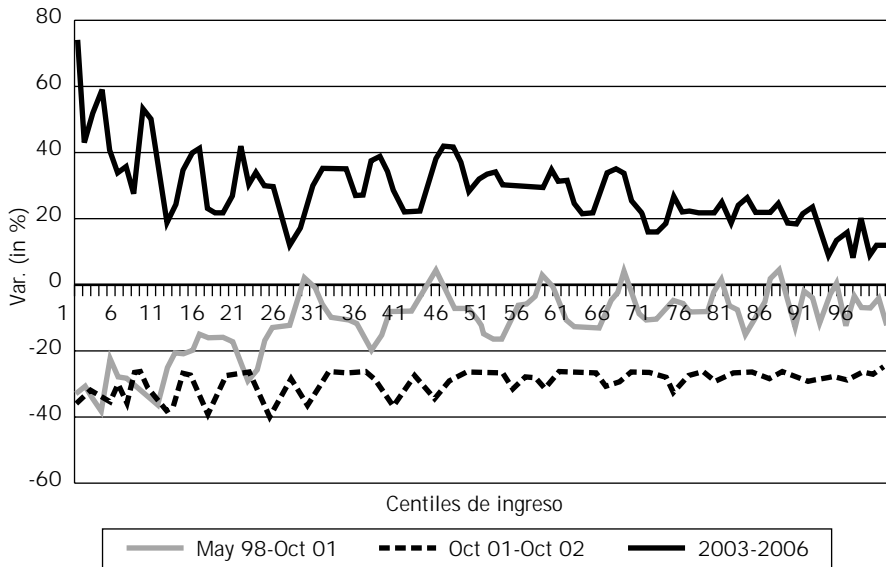
Source: Calculation by the authors, based on data from EPH (INDEC)

incomes that affected lower incomes with greater intensity. On the other hand, the variation in the period 2001-2002 was relatively homogeneous all along the distribution line due to the already mentioned impact of the increase in prices. Lastly, since 2003 the improvement in real wages was greater among the first percentiles, a fact that is consistent with the reduction in the wage gap previously mentioned.

Despite the reversal in the trend towards greater inequality, the concentration of income is still high due to the high level of income inequality prior to the change of regime (Table 9). In the first semester of 2006, whereas the first quintile of employed workers received 4 per cent of total wages, the fifth quintile received approximately 48 per cent. Moreover, average income of the latter group was 12 times the average income of the first quintile (such ratio was of 15 times at the beginning of 2003).

As can be deduced from Table 7, the occupational category is one of the dimensions through which the strong heterogeneity among workers is clearly seen, and in particular, the condition of being registered or not among the wage earners. In effect, in the first semester of 2006, those

Graph 15 – Variation in real income from main occupation, according to percentiles of income



Source: Calculation by the authors, based on data from EPH (INDEC)

wage earners in the private sector not covered by social security received, on average, incomes that represented 43 per cent of the incomes of registered wage earners in the private sector.

Hence, even though the wage improvement has been greater among the unregistered wage earners compared to the rest of wage earners there is still a significant gap between the two groups. This fact is reflecting the effects of a labour market that has been showing a tendency towards segmentation as a result of the low global dynamism of the labour market throughout the nineties. On the one hand, there is a group of workers that receives higher incomes and is covered by social security and, on the other hand, there is a group of workers with low wages, in precarious jobs and without social security protection.

However, income differentials between both groups could be affected by a dissimilar composition of employment (in terms of personal and occupational characteristics) within each of these groups. In particular, this could be reflecting the fact that low-skilled wage earners and part-time workers represent a high proportion of unregistered workers. If this is so, the observed wage gap could not be exclusively attributable

**Table 9 – Quintile distribution of incomes from main occupation
28 urban centers. Excludes employment plans**

Quintil	I Sem 03	II Sem 03	I Sem 04	II Sem 04	I Sem 05	II Sem 05	I Sem 06
1	3.3%	3.7%	3.9%	3.9%	4.2%	4.0%	4.1%
2	9.0%	9.4%	9.6%	9.7%	9.8%	9.7%	10.1%
3	14.7%	14.3%	14.7%	15.1%	15.3%	15.5%	15.4%
4	21.8%	21.5%	21.3%	22.1%	21.6%	22.3%	22.2%
5	51.1%	51.0%	50.5%	49.3%	49.2%	50.2%	48.1%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Calculation by the authors, based on data from EPH (INDEC)

to the occupational category and to the condition of being registered or not.

In order to quantify the effect of the above-mentioned dimension, as well as the influence of other attributes, different wage and worked-hours equations were estimated for the first semester of 2006 (Table 10).³⁸ The first three regressions were estimated for the totality of employed workers, whereas the fourth only considered those that work more than 35 hours per week. In addition, the dependant variable in regression I is the monthly income from the main occupation (in logarithms), in regression II is the hourly wage, and in III is the logarithm of worked hours. Regression IV is the same as regression I but estimated for wage earners that work more than 35 hours per week.

In all the estimations of wages it is verified that the occupational category is a very relevant dimension to explain the gaps between employed workers. Given other characteristics of workers, unregistered wage earners that work full time received at the beginning of 2006 an income approximately 50 per cent lower than the income of registered full-time wage earners (regression IV), a phenomenon that is consistent with what was previously mentioned. On the other hand, the gap between registered wage earners and non-wage earners is smaller but significant, of approximately 37 per cent.

³⁸ In all the estimations, the control group is comprised by women wage-earners, registered in the social security system, non-household heads, with incomplete primary education and that work in the manufacturing industry. The estimations take into account the correction for selectivity bias by using Heckman's methodology.

Table 10 – Income equations

	Total employed			Reg. IV Employed more than 35hs
	Regression I Monthly Wage	Regression II Hourly Wage	Regresión III Hours	
Category				
Non-registered	-0.677 (65.74)**	-0.427 (42.95)**	-0.248 (28.18)**	-0.497 (46.23)**
Non-wage earner	-0.579 (53.69)**	-0.352 (33.76)**	-0.227 (24.67)**	-0.37 (33.57)**
Education				
Complete primary school	0.218 (13.17)**	0.138 (8.61)**	0.08 (5.63)**	0.183 (10.00)**
Incomplete secondary school	0.35 (20.27)**	0.258 (15.45)**	0.091 (6.14)**	0.33 (17.45)**
Complete secondary school	0.568 (33.44)**	0.415 (25.33)**	0.15 (10.30)**	0.484 (26.12)**
Incomplete university	0.654 (35.43)**	0.614 (34.38)**	0.043 (2.73)**	0.616 (30.30)**
Complete university	0.952 (51.583)**	0.903 (50.29)**	0.066 (4.16)**	0.934 (45.71)**
Branch of activity				
Construction	-0.066 (4.21)**	-0.042 (2.80)**	-0.018 -1.34	-0.083 (5.41)**
Commerce	-0.064 (5.54)**	-0.194 (17.44)**	0.133 (13.48)**	-0.105 (9.14)**
Transport and financial service	0.102 (5.96)**	-0.053 (3.16)**	0.161 (10.95)**	-0.051 (3.14)**
Health and education	-0.112 (8.90)**	0.138 (11.21)**	-0.239 (21.90)**	-0.05 (3.72)**
Other industries	-0.235 (17.31)**	0.006 -0.47	-0.241 (20.84)**	-0.107 (7.16)**
Age	0.058 (33.07)**	0.036 (21.29)**	0.021 (14.18)**	0.046 (22.99)**
Age2	-0.001 (29.74)**	-0.0003 (16.54)**	-0.0003 (15.76)**	-0.0005 (19.66)**
Man	0.393 (42.49)**	0.133 (14.84)**	0.263 (33.09)**	0.249 (24.68)**
Household head	0.15 (16.37)**	0.077 (8.64)**	0.077 (9.85)**	0.137 (14.01)**
Constant	4.91 (122.77)**	0.454 (11.79)**	3.086 (90.42)**	5.364 (120.71)**
Observations	30049	28306	28306	18856
R-squared	0.48	0.42	0.2	0.46

Absolute value of t statistics in parentheses

* significant at 5%; ** significant at 1%

Source: Calculation by the authors based on data from EPH (INDEC)

When considering the total of employed workers, the monthly income differentials according to this dimension are even wider. In effect, the unregistered workers receive a wage 68 per cent lower than the registered ones. The gaps are narrower when calculated in terms of hourly incomes. These results would be reflecting that, other attributes being equal, registered wage earners receive higher monthly labour incomes than the rest of the employed workers both because they get higher hourly wages and because they work more hours. This last fact is confirmed by regression III, which shows that unregistered workers work 25 per cent less hours per week than registered wage earners. A similar gap is observed between the latter and the group of non-wage earners.

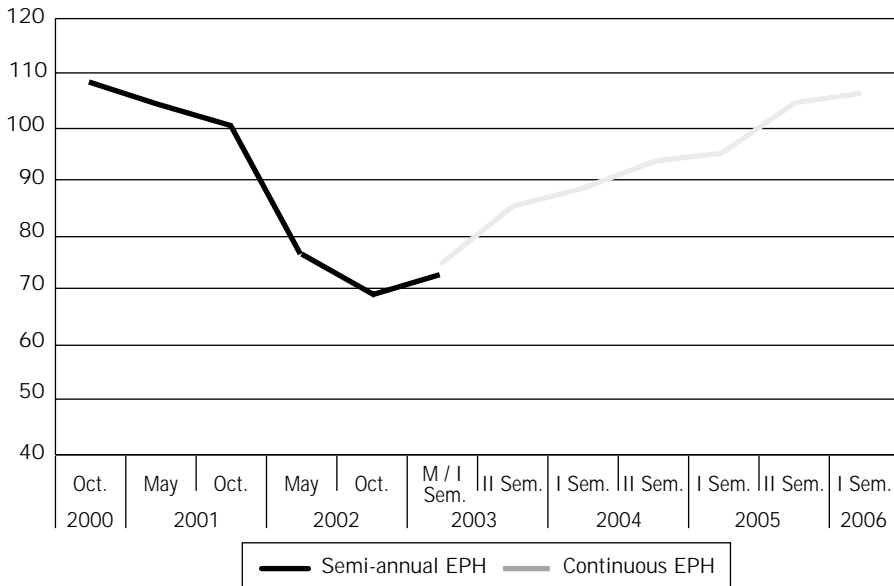
Returns from education also significantly contribute to the wage differentials observed within the labour force. Monthly wages of those that have completed primary school are between 14 per cent and 22 per cent -depending on the specification of the model- higher than wages of those that have not completed this level of education. In the other extreme, complete university studies allows incomes 90 per cent higher than those of incomplete primary school. Like what happens with occupational category, the gaps widen because the most qualified workers receive higher hourly incomes and also work more hours.

Furthermore, as it is usual in this type of equations, men and heads of household receive higher wages (monthly and hourly) than women and other household members, respectively. On the other hand, the age has a positive although non-linear effect on labour incomes; and manufacturing activities are among those that pay the highest wages (except, in general terms, transport and financial services).

Family incomes and their distribution

Given the importance of the labour market in the generation of family incomes, the dynamics of labour has been having a strong impact in the performance of family incomes. In effect, as a result of the favorable evolution of employment and the recovery of wages, family incomes started a process of sustained growth since 2003 that continues at present times. They grew about 42 per cent in real terms in the period (Graph 16). This process has allowed the full recovery of purchasing power and even the achievement of higher levels than the late-2001 average levels. This process has been accompanied with an improvement in the concentration of family incomes.

Graph 16 – Real per-capita family income in 28 urban centres, 2000-2006. Includes employment plans and annual complementary salary. (Index Oct.01=100)

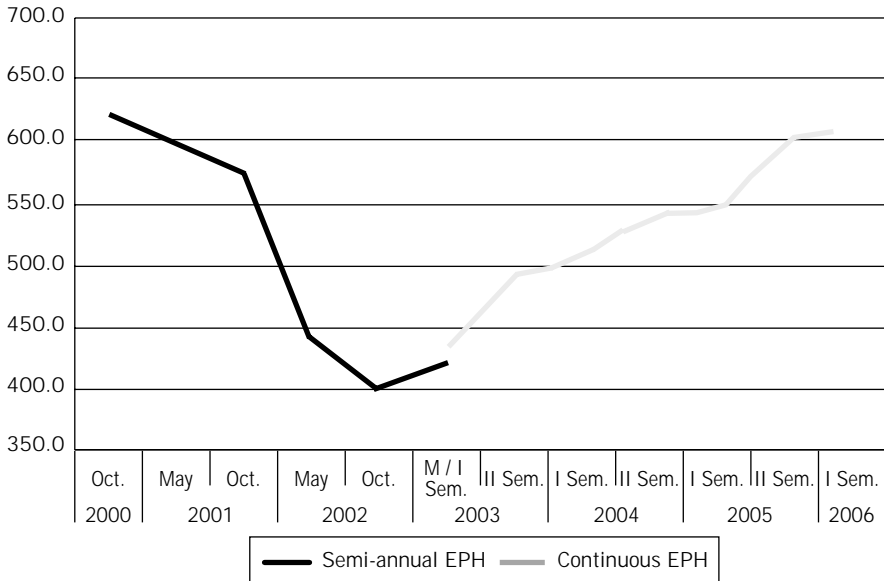


Source: Calculation by the authors, based on data from EPH (INDEC)

Contrary to what happened among workers, in the semester that followed the exit from the Convertibility family incomes inequality rose, mainly as a consequence of the increase in unemployment. This is reflected in the deterioration of the Gini index of per capita family incomes that passed from 0.520 to 0.541 between October 2001 and May 2002. After the maximum concentration level reached in May 2002, the concentration trend reversed. One of the factors that initially explained this turning point was the implementation of the “Plan Jefas y Jefes de Hogar Desocupados” (PJJHD)³⁹, since it gave employment and/or incomes to the poorest families. Its impact is reflected in the fall of the Gini index of total family income between May and October 2002, which in absence of this plan would have recorded 0.505 instead of 0.489. As from 2003 the inequality among households has shown a sustained decreasing trend that allowed a 5 p.p reduction in the Gini index,

³⁹ The PJJHD was implemented in 2002 by the National Government in response to the critical social situation of the country at that time. The plan established a fixed-amount of \$150 household heads that were unemployed with children up to 18 years. In 2003 it reached around 2 million households and since then it has been systematically reducing its coverage.

Graph 17 – Real per-capita family income in 28 urban centres, 2000-2006. Includes employment plans and annual complementary salary



Source: Calculation by the authors, based on data from EPH (INDEC)

from 0.532 to 0.486, between that year and the first semester of 2006 (Graph 17).

This greater equality among households is also revealed in the ratio between the first and the fifth quintiles of total family incomes. Whereas in the first semester of 2003 the average per capita income of the fifth quintile represented 25 times the corresponding to the first quintile, in the first semester of 2006 the gap has reduced to 15 times (Table 11). This responds to the fact that, although real incomes rose for every quintile, the increases were larger among the poorest households. In effect, throughout this period the households in the first quintile doubled the purchasing power of their incomes whereas the real incomes of the richest households increased 30 per cent. Furthermore, this was mainly due to the significant reduction in open unemployment (which affects to a greater extent those households in the lower extreme of the distribution) and, to a less extent to the recovery of wages.

In spite of these dynamics, the concentration of family income is still high. In the first semester of 2006, the 20 per cent poorest households received only 4 per cent of total income, whereas the fifth quintile

Table 11 – Average per capita family income by quintiles in 28 urban centres, 2003-2006. Includes employment plans and annual complementary salary

Quintil	I Sem 03	II Sem 03	I Sem 04	II Sem 04	I Sem 05	II Sem 05	I Sem 06
1	50.0	65.3	78.5	84.6	90.8	101.4	105.2
2	148.6	176.3	193.3	212.3	217.9	247.0	256.7
3	265.2	302.3	320.2	349.3	358.6	399.5	417.5
4	450.1	514.2	522.6	569.2	576.1	642.7	660.2
5	1236.5	1390.4	1425.8	1479.1	1475.7	1612.7	1609.5
Average	429.6	489.6	507.9	538.5	543.4	599.9	609.5
5 quintil/ 1 quintil	25	21	28	17	16	16	15

Source: Calculation by the authors, based on data from EPH (INDEC)

captured 50 per cent. On the other hand, the ratio of average per capita incomes between both groups was 15 times -and it was 25 times in 2003. (Table 11).

Poverty and indigence⁴⁰

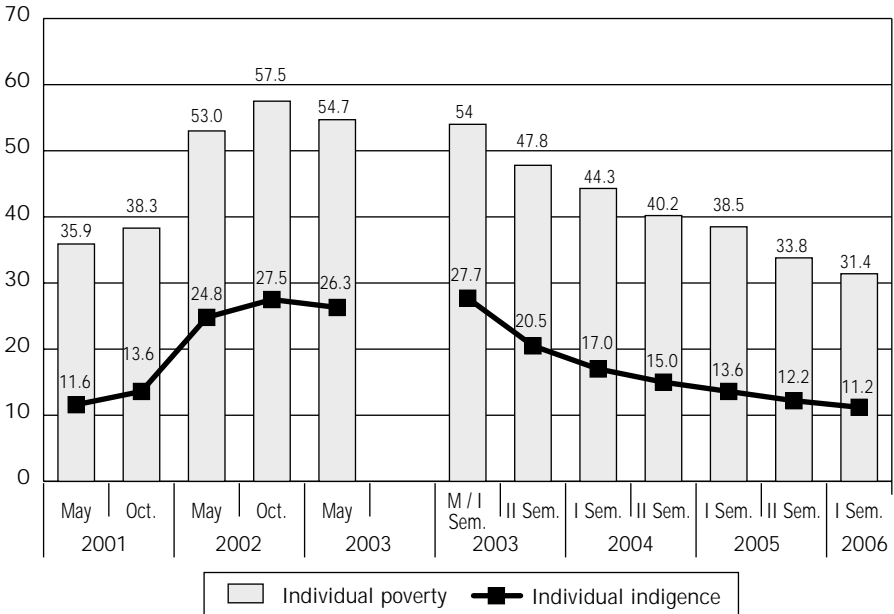
Even before the end of the Convertibility, 38 per cent of the population lived in households with incomes below the poverty line. Ten months after the devaluation of the peso, this proportion rose to 57.5 per cent of the urban population, and in the period between October 2001 and May 2002 the percentage of poor households increased 13.4 p.p (Graph 18). This deterioration of the living conditions can be also seen in the poverty gap⁴¹. In May 2002, poor households needed, on average, to more than double their incomes in order to surpass the poverty line.

Hence, the extremely high level of poverty reached after the exit from the Convertibility is explained, on the one hand, by the magnitude of the shock, especially in terms of the fall of real wages and, on the other hand, by the serious situation prior to the collapse.

⁴⁰ The incidence of poverty is the proportion of households (or population) that cannot afford a basic basket of goods and services. Poverty due to lack of incomes differs from the standard international measures (of one dollar per day per person, for example) because the value of the reference basket is calculated based on domestic prices and patterns of consumption.

⁴¹ The poverty gap measures the percentage difference between average incomes of poor households and the line of poverty.

Graph 18 – Poverty and indigence in 28 urban centres, 2001-2006



Source: Calculation by the authors, based on data from EPH (INDEC)

This unfavourable dynamic of the social situation was due to the joint effect of the decrease in average real wages and their more unequal distribution. Therefore, it seems important to quantify the relevance of each of these factors. In particular, the variations in the level of poverty can be decomposed in two effects⁴²: on the one hand, the change experienced as a consequence of the variations in the household total average real income, maintaining the distribution constant -growth effect- and, on the other hand, as a consequence of distributive effects, with a constant average income -distribution effect. The growth effect can in turn be decomposed in the “inflation effect” and in the “nominal income effect”. The former effect indicates how large the variation in the poverty level would have been with constant nominal incomes and distribution. The latter quantifies the impact of the changes in incomes under the assumption that prices and distribution remain constant. The results are shown in table 12.⁴³

⁴² This decomposition is based on Datt and Ravallion (1990). The decomposition is not exact due to the existence of crossed effects between the two components.

⁴³ The negative sign means that the effect in consideration worked in the opposite direction than the variation of poverty.

Table 12 – Decomposition of poverty variation (households)

Period	Variation (p.p.)	Growth effect	Inflation effect	Nominal income effect	Distribution effect	Residual
O00-O01	4,7	70%	-6%	74%	30%	2%
O01-M02	12,3	98%	63%	28%	10%	-1%
M02-O02	4,8	72%	150%	-63%	9%	4%
O02-M03	-3,1	85%	-2%	89%	18%	-5%
II S03-II S04-	-6,7	72%	-36%	97%	29%	9%
II S04-II S05-	-5,1	72%	-66%	133%	22%	10%
II S03-I S06-	-13,4	72%	-61%	116%	27%	189%

Source: Calculation by the authors, based on data from EPH (INDEC)

During the last year of Convertibility, the fall in household total incomes explained 70 per cent of the increase in poverty (income effect), even though deflation slightly attenuated the fall in real incomes since it made the basic basket cheaper. On the other hand, the deterioration in income distribution explained the other 30 per cent of the increase in poverty. As from that moment, the distribution effect loses its relevance and the increases in poverty levels become mainly explained by the deterioration of real incomes due to inflation in the first semester of 2002. In particular, between May and October 2002, the increases in family incomes (the negative sign of the nominal income effect) were not sufficient to compensate for the price increases. Therefore poverty continued to rise, although at a lower pace than in the previous semester. The increase in family incomes in this period is explained, to a great extent, by the rapid expansion of the PJJHD, from which poor and indigent households benefited (Table 12).⁴⁴

The negative trend in the social situation reversed since 2003. As it was already mentioned, the joint result of the increase in employment and wages led to a process of growth in family incomes and a simultaneous gradual improvement in their distribution. This is shown in table 12, since both the “growth effect” and the “distribution effect” have been important in the reduction of poverty (although the effect of the former

⁴⁴ Even though the plan was correctly focused on the poorest population, the impact on the poverty incidence was small because the amount of the transfer was low in relation to the value of the basket. There has been a larger effect in the case of indigence. In addition, currently the impact of the plan on both indicators is small given the reduction in the number of beneficiaries since 2003.

Table 13 – Household indicators, according to poverty condition in 28 urban centres, second semester of 2005

Average indicators per household	Total households	Non-poor households	Poor households
Total family income	1.506	1.810	531
Per capita income	453	622	114
Individuals	3.31	2.91	4.54
Younger than 14 years old	0.8	0.5	1.6
Unemployment rate (%)	10.6	7.0	20.3
Activity rate (%)	46.1	50.8	36.7
Employment rate (%)	41.2	47.3	29.3

Source: EPH (INDEC)

was greater, of 70 per cent against 30 per cent of the latter). In addition, it can be seen that real incomes were able to rise despite the increase in the value of the basic basket (which is reflected in the negative sign of the inflation effect), especially in the more recent periods.

This allowed the percentage of individuals in poor households to decrease 23 p.p. -from 54 per cent to 31.4 per cent — between the first semester of 2003 and the first semester of 2006, while in the case of indigent individuals the proportion fell 16.5 p.p. in the same period -from 27.7 per cent to 11.2 per cent.

Poor households not only receive lower incomes per household than non-poor households but they are also larger in size (4.5 vs. 2.9). Therefore, the incomes gap per person between these two groups of households is even wider. In the second semester of 2005, whereas non-poor households receive approximately 3 times the average family income of poor households, this differential reached 5 times in the case of per capita income (Table 13).

In addition, poor households present a higher average dependency rate (lower employment rate), because they have more individuals younger than 14 years old and also because the adults have a deficient insertion in the labour market. In the second semester of 2005, the activity rate of poor households was 14 p.p. lower than the rate of non-poor households, while the unemployment rate was 3 times higher (20 per cent and 7 per cent, respectively; see Table 13).

Another way of characterizing poverty consists of describing the family household head profile according to the type of household he/she

Table 14 – Characteristics of household heads between 25 and 65 years old in 28 urban centres, includes employment plans. First semester of 2006

	Poor householdss	Non-poor households
Condition		
Employed	73.8%	88.5%
Unemployed	11.0%	2.9%
Inactive	15.2%	8.6%
Educational level		
Incomplete secondary school or less	80.3%	42.6%
Complete secondary school and incomplete university	16.8%	35.4%
Complete university	2.9%	22.0%
Occupational category		
Registered	20.2%	56.5%
Non-registered	48.5%	19.0%
Non-wage earners	31.4%	24.5%
Branch of activity		
Industry	13.0%	15.6%
Construction	20.9%	7.3%
Commerce, restaurants and hotels	22.4%	20.2%
Transport and services to companies	5.6%	9.0%
Financial services	5.0%	11.4%
Health and education services	15.2%	23.8%
Personal services	17.5%	12.7%

Source: Calculation by the authors, based on data from EPH (INDEC)

belongs to. In the first semester of 2006, the percentage of employed household heads belonging to poor households was 15 p.p. lower than the percentage of employed household heads in non-poor households, while the incidence of unemployment for household heads in poor households was four times the corresponding incidence in non-poor households -11 per cent vs. 3 per cent (Table 14).

This situation is in part related to the different educational levels among household heads. In effect, when considering this dimension it can be seen that 20 per cent of household heads in poor households had completed secondary school while the percentage rose to 60 per cent for the average of the rest of households. Moreover, only approximately 3 per

cent of the former group's household heads had completed university, while this percentage was 22 per cent for the rest of households.

Regarding employed household heads, there is a wide discrepancy in terms of occupational category. Precarious employment has a significant incidence among the poor households: approximately one half of employed household heads works in jobs not covered by social security, while the figure decreases to 19 per cent for the rest of the families. On the contrary, in the latter group 57 per cent of household heads work in jobs covered by social security against 20 per cent in poor households. This fact indicates that poverty is not only associated to events of unemployment but also to the poor quality of employment among poorer groups, referred to in this case as the "working poor".

Lastly, the branch of activity to which the household head belongs is also distributed in a different way between these two groups of households, with the only exception of industrial activities. In particular, construction and personal services present a larger concentration among poor households whereas the contrary is verified regarding financial services, transport and services to companies, as well as health and education services.

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