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Do Cry for Argentina

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We should all cry for Argentina -- and not simply because it defaulted on its government debt or because it faces a host of economic problems. Unemployment exceeds 18 percent, the banking system is on the brink of collapse, and things will get worse before they get better. What makes the crisis truly disheartening is that it is merely the latest in a series stretching back over a century. Something in Argentina's history and culture seems to prevent strong and stable economic growth.

By all rights, Argentina should be one of the world's richest countries. Indeed, it once was. In 1913, average income per person (expressed in "constant" 1990 dollars) was about $3,797 and was higher than in France ($3,485) and Germany ($3,648), according to the estimates by Angus Maddison of the Organization for Economic Cooperation and Development. This earlier prosperity stemmed heavily from vast investments made mainly by the British in railroads and ports to exploit Argentina's rich agricultural lands. With 37 million people, Argentina's population is 4 percent of India's, but its land area is 85 percent of India's. On the numbers, Argentina should be as rich as, say, Canada or Australia.

But it isn't. Its present income per person ($9,219 in 1998, again in 1990 "constant" dollars) is roughly half of Canada's ($20,559), Australia's ($20,390), France's ($19,558) and Germany's ($17,799). In the past 80 years, Argentina has achieved faltering economic growth with frequent episodes of hyperinflation. Its periodic crises actually date to the 19th century. In 1890, Argentina defaulted on loans -- in gold -- made by the British investment bank Barings, triggering one of the earliest international debt crises.

The latest default is a cautionary tale for "globalization." In many respects, Argentina did the "correct" things in the 1990s. It eliminated hyperinflation (more than 1,000 percent in 1990) by creating a currency board. Under the currency board, the government couldn't issue new pesos unless it had dollars to back them on a one-to-one basis. Likewise, Argentina opened itself to foreign capital and received huge inflows of direct investment -- almost $80 billion from 1991 to 2000. Foreign companies invested heavily in Argentina's oil, telecommunications and banking industries. But the resulting economic gains were ultimately offset by longstanding weaknesses: chronic government deficits; tax evasion; a weak entrepreneurial class; and uncompetitive wages.

"Mistrust is rife in Argentina," says Lawrence Harrison of Tufts University, co-editor of "Culture Matters: How Values Shape Human Progress." It is hard to cooperate for the common good. Tax cheating is widespread. Labor unions promote rigid work rules. "You can't fire anyone," says economist Sebastian Edwards of the University of California at Los Angeles. "If you do, you . . . pay severance that's fantastic."

Although the currency board is widely blamed for the present crisis, the case is overstated. True, Argentina's exports suffered competitive disadvantage because the foreign-exchange value of the dollar (to which the peso was tied) was high and because Argentina's neighbors (Brazil, Chile) let their currencies decline. But weak exports didn't cause the crisis for two reasons: First, they represent only a small part of Argentina's economy (they're about 10 percent of gross domestic product); and second, they held up fairly well (exports were $26 billion in both 1997 and 2000, reports the International Monetary Fund).

"The key thing that did [Argentina] in was that the government at the federal level and the provincial levels continued to spend more than they took in," says Michael Mussa, the International Monetary Fund's former chief economist. Politicians showered benefits on favored constituents. Relying on government borrowing to power the economy couldn't continue forever. With the currency board, the government couldn't print money to cover deficits; that prevented hyperinflation. But as debt rose, lenders -- foreign and domestic -- grew reluctant to lend. By early 2001, Argentina was effectively shut out of credit markets, says Mussa.

Argentina turned to the IMF for loans, but -- to restore confidence -- the IMF wanted the budget deficit cut through higher taxes or lower spending. The effect was to worsen the slump. A vicious circle ensued. A deeper recession aggravated the budget deficit; steps to reduce the deficit aggravated the recession.

But the critical failure was what wasn't there: a vibrant business sector that can create new companies and jobs. What Argentina lacks are "institutions to select the right entrepreneurs, to motivate them, to provide them with sophisticated managers, to provide free entry to markets without permissions, fees and bribes," wrote Columbia University economist Edmund Phelps recently in the Financial Times.

Argentina's immediate prospects are dismal. Without the currency board, there's fear of rapid inflation. To frustrate bank runs -- people want to get their dollar deposits out -- the government has imposed a partial ban on withdrawals. The banks are shaky, because many loans were converted from dollars to devalued pesos while dollar deposits were not converted. So banks will receive cheapened pesos while retaining obligations in expensive dollars. The loss: a minimum of $5 billion. Confidence has collapsed.

For Argentina, globalization has been no panacea, because greater trade and international investment don't automatically alter local attitudes and politics. Argentina's predicament applies, in some ways, to much of Latin America and may explain why the gains from rising globalization have been fairly modest. From 1991 to 2000, Latin America's economic growth averaged only 3.3 percent compared with 7.2 percent for East Asian countries (China, South Korea, Thailand and others), says Edwards.

Perhaps Argentina's crisis will harm only Argentina. But because globalization promised so much more than it has delivered, the crisis may foretell a wider political and psychological fatigue. "I travel a lot to these 'emerging market' countries," says economist Arturo Porzecanski of ABN Amro. "There's a lot of disenchantment. . . . Everywhere people are disenchanted."