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The Credibility of Economic Policy Making in Argentina, 1989–2015

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Abstract

This paper explores the hypothesis that the credibility of economic policy making in Argentina (or lack thereof) has impacted the volatility of economic performance. To establish the link, a historical review of economic policy making and economic outcomes over the quarter century is presented, informed by a survey of the literature on credibility and the political economy of reforms. A more fundamental question is why policy shifts are so frequent, and this necessarily relates to the political institutions underlying policy making. A recent literature on citizen engagement and accountability, combined with international experience, is then used to consider policy options that could help reestablish credibility during the new administration.

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The Credibility of Economic Policy Making in Argentina, 1989-2015

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I. Motivation and definitions

Since the early 1990s, the Argentine economy emerged from hyperinflation and stagnation to experience multiple growth accelerations followed by either stagnation or recession, including one severe crisis in 2001-2002. Standard measures of macroeconomic volatility establish Argentina as a clear outlier.

The last quarter century has also been a period of dramatic shifts in economic policy-making in Argentina, at both the macro and micro levels. Examples include the following: exchange rates--from a hard peg (currency board) to managed float to dual exchange rate regime; state-owned enterprises--from a wave of privatization of to a wave of nationalizations; and trade--from a gradual opening (within the context of Mercosur) to unilateral import controls. This is not to pass value judgments on the policies themselves, but to make note that they represent strong shifts in the direction of economic policy. Such has been the volatility of policies and outcomes over this period that two Argentine authors ask the question: "Stop and go" or "Go and Fail"? (Albrieu and Fanelli, 2008). Another Argentine economist dubbed the phrase the "Macroeconomics of Broken Promises" (Heymann, 2007).

This paper explores the hypothesis that the credibility of economic policy making in Argentina (or lack thereof) has impacted the volatility of economic performance over the period 1989-2015. To establish the link, a historical review of economic policy making and economic outcomes over the last quarter century is presented, informed by a survey of the literature on credibility and the political economy of reforms. A more fundamental question is why policy shifts are so frequent, and this necessarily relates to the political institutions underlying policy making. The survey, combined with international experience, is then used to consider policy options that could help reestablish credibility during the new administration.

Webster defines "credible," as "offering reasonable grounds for being believed." For economic policy making, Calvo (1989) defined (the lack of) credibility as the "nonconformity of expectations with announcements." For the purpose of this paper, one can use the following definitions for the credibility of economic institutions:

(a) *Macroeconomic* credibility. (i) *Monetary Policy*. Given its institutional role, one can focus on the central bank, and adopt the following definition: "Central Bank credibility is defined as a commitment to follow well-articulated and transparent rules and policy goals."[1] (Bordo and Syklos, 2015). (ii) *Fiscal Policy* credibility can be defined in similar terms; however, quantitative fixed rules ("fiscal rules" and/or "fiscal responsibility laws") have been adopted more generally in practice than, say, the "Taylor Rule" for monetary policy.

(b) *Microeconomic* credibility. Commitment to a "level playing field" for businesses and workers; i.e., non-discriminatory regulations (including the trade regime) and taxation. The

[1] The authors then develop an empirical measure of credibility based on deviations in inflation from inflation objectives, whether the latter are explicit or implicit.

commitment is not necessarily to *not change* policy, but rather that the decision making process is one that is transparent and accountable to the concerns of the broad population, as opposed to narrow special interests.

Note that the macroeconomic definition seems more precise. The institutional role of the central bank, combined with the increasing degree of central bank independence in recent decades, opens greater scope for clearly stated objectives, and even rules, or guidelines based on the evolution of the economy. On the fiscal policy side, the budget—as an instrument—lends itself to establishing a clearly stated target for fiscal outcomes, and a number of countries have adopted medium-term expenditure frameworks and/or multi-year budget plans. The microeconomic definition is less clear and highly idealized. In no country is there ever a fully level "playing field," and in most countries, substantial resources are devoted by businesses to lobby for or against particular regulations. In some cases, those efforts might be directed to avoiding discriminatory policies; however, in other cases, they may be directed towards "tilting the playing field" in a favorable way for a particular industry, firm, or sector.

Moving from institutions to specific policy actions, one might refine the characteristics of policies that one would expect to increase credibility – especially given the history of policy reversals in Argentina. More specifically, for this paper, we will use the following three characteristics: (i) the policy has internal logic and rationale and appears to have the right magnitude to achieve its goals; (ii) the policy is based on reliable data and trusted institutions; and (iii) the policy is consistent with a longer-term vision or strategic direction.[2]

This paper surveys the last twenty-five years of economic policies and performance in Argentina. It establishes some broad stylized facts: namely, a high frequency of policy reversals has been accompanied by a high degree of economic volatility. This reputation for policy reversals leads markets to react disproportionately to adverse economic shocks. The organization of the paper is as follows. First, there is a section on macro-economic performance in comparative perspective to set the stage. Then, the paper is divided into macro-economic and micro-economic policy realms. In both these sections, the historical survey is complemented by references to the empirical and theoretical literature. A section then discusses the macro-micro linkages in the political economy of reform. The final section of the paper draws on the earlier discussion to glean potential lessons for credible policy reforms for the next administration.

II. Macroeconomic performance in comparative perspective

It is instructive to compare Argentina's macroeconomic performance over the 25 year period to a relevant set of comparator countries. Given the long time frame, the occurrence of both global and country-specific shocks, one diverse group of comparators would be the other emerging market economies in the G20: namely, Argentina, Brazil, China, India, Indonesia, Mexico, Russian Federation, Saudi Arabia, South Africa and Turkey.

[2] Thanks to Zafer Mustafaoglu for suggesting these characteristics.

Table 1: Macro performance in emerging markets of the G20, period averages, 1990-c2014

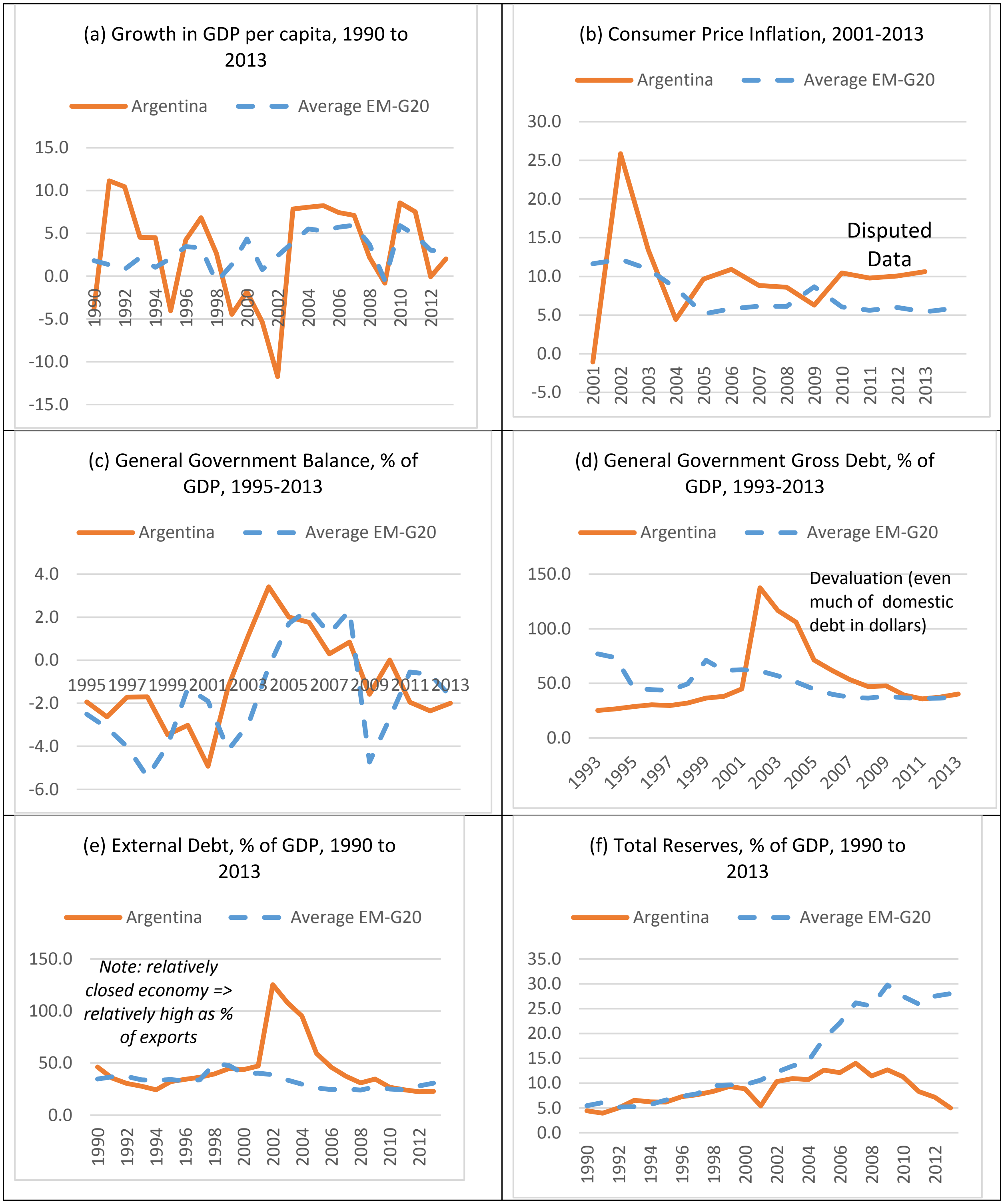
	Real GDP growth	Standard Deviation of Real GDP growth	Per capita GDP growth	Inflation (CPI)	General government net lending/borrowing (% of GDP)	General Government Gross Debt (% of GDP)
Argentina	3.95	***5.68***	2.97	9.8	-1.00	51.7
Brazil	2.68	2.58	1.35	345.8	-3.88	66.6
China	9.92	2.45	9.03	4.4	-1.22	33.9
India	6.51	2.24	3.63	7.9	-7.43	73.6
Indonesia	5.06	4.12	4.79	10.3	-0.82	41.2
Mexico	2.79	3.02	1.28	11.0	-2.88	43.0
Russia	1.98	6.44	0.93	78.7	1.26	26.9
Saudi Arabia	4.36	3.28	1.88	1.6	9.44	40.7
South Africa	2.48	2.09	2.75	7.5	-2.08	35.8
Turkey	4.25	4.84	0.69	41.8	-4.03	50.6
Average	4.40	3.67	2.93	51.9	-1.27	46.4

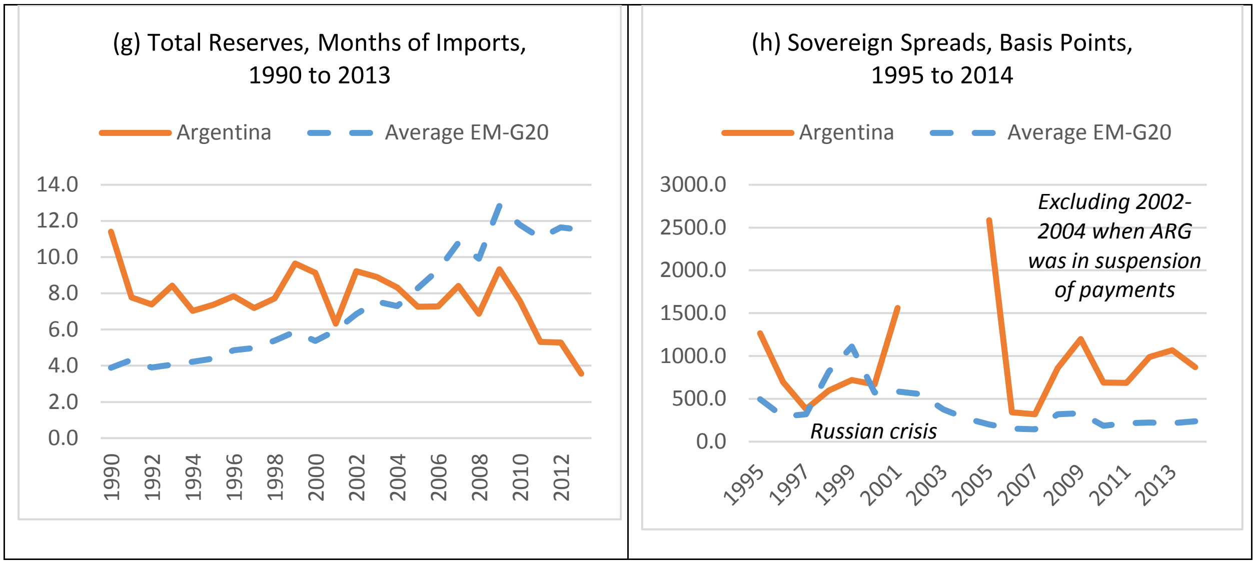
	External Debt Stock (% of GNI)	Current Account Balance (% of GDP)	Total reserves (in % of GDP)	Total reserves in months of imports (in % of GDP)	Sovereign Bond Interest Rate Spread, basis points over US Treasuries
Argentina	44. 8	-0.1	8.6	7.7	***912****
Brazil	27.8	-1.5	8.6	8.4	545
China	13.2	4.1	25.6	12.9	120
India	22.3	-1.3	12.0	7.6	N/A
Indonesia	62.0	0.2	12.5	5.4	288
Mexico	28.4	-2.2	7.5	3.3	276
Russia	41.3	5.8	17.4	8.0	706
Saudi Arabia	N/A	6.9	36.4	13.5	N/A
South Africa	24.4	-1.6	6.8	2.8	226
Turkey	42.9	-2.9	9.8	4.6	395
Average	34.1	0.7	14.5	7.4	365

*Excluding the period 2002-2004 when Argentina was in default with foreign creditors.

Sources: WDI; WEO Database; Authors' Calculations

Figures 1(a)-(h): Argentine macroeconomic performance in comparative perspective





Sources: WDI; WEO Databases, Author's calculations

Table 1 provides information on period averages for Argentina and comparator countries for a variety of standard indicators. One sees that Argentina is slightly above average on the degree of general government and external indebtedness, but where Argentina really stands out is in terms of the volatility of growth (column 2) and sovereign risk (bottom of the last column). On the latter, the numbers for Argentina would be substantially higher if one were to include the debt default years in the period average. Similarly, if one compares Argentina to the comparator country average over time (Figure 1(a)-(h)), one sees persistently higher volatility and country risk – one indicator of economic policy credibility.[3] In brief, Argentina's macroeconomic indicators look fairly "normal" for a large emerging market economy over the period, with the exception of modestly high indebtedness, and sharply higher volatility and country risk.

III. Macroeconomic policy

The Historical Context and the Convertibility Period[4]

Argentina emerged from extremely poor macro-economic performance in the 1980s to improved but highly volatile performance over the last twenty-five years. The 1980s was a period of debt distress, slow growth and periodic hyperinflation and adjustment. These conditions persisted into the difficult first two years of the Menem Administration who had been elected in 1989. Annual inflation ran into the thousands of percent for 1989 and 1990.[5]

In March 1991, Argentina embarked on a new economic strategy with the Convertibility Plan. The centerpiece of the plan was the creation of a currency board arrangement, with the peso

[3] In Figure 1(g), Argentina does not participate in the rising reserves of other Emerging Market G20 (EM-G20) countries. It should be noted, however, that the rising reserve ratios of EM-G20 average is being driven by the sharp increase in reserves in several "BRIC" countries during the first decade of the century.

[4] Annex 1 has a timeline of key political, economic policy and external events.

[5] Buera et al, 2011, analyze the longer history of Argentine growth (200 years) and conclude that there was a secular slowdown in economic growth since 1974, accompanied by greater volatility in growth. The latter is attributed to problems of fiscal management.

fixed to the dollar at parity.[6] The "rules of the game" were clear and transparent and direct: pesos could not be created unless they were backed by international reserves. Some monetary policy discretion was introduced when it was established that two-thirds coverage in international reserves would be required, rather than 100 percent. The other third could be backed by dollar-denominated government bonds.[7] In brief, there was a strict, well-articulated, and transparent rule on money creation. The immediate monetary policy goal was to end hyperinflation. Monetary policy seemingly conformed to the broad definition of credibility, as defined in the introduction.

In the early 1990s, there was already a literature on exchange rate-based stabilizations, given the experience of a number of countries in the late 1970s and early 1980s. In addition, the theoretical literature had advanced and introduced a number of subtleties. In particular, the time consistency problem of monetary policy, given forward looking expectations of economic agents, had already been established in the literature in the 1970s (Kydland and Prescott, 1977; Calvo, 1978). The monetary policy decision maker would be tempted to "surprise" economic agents in the future, and economic agents understanding this temptation would adjust their expectations accordingly – resulting in an inflationary bias in monetary policy. The temptation to "surprise" creates mistrust, or a lack of credibility of monetary policy announcements. The literature later developed various proposed solutions: (i) fixed *ex ante* monetary policy rules (e.g., Taylor, 1993)[8]; (ii) delegation of monetary policy decisions to an independent individual or council (Rogoff, 1985; Lohmann, 1992)[9]; or (iii) "importing credibility through exchange rate pegging" (Herrendorf, 1997). In recent years, advanced economies have used "forward guidance" as a means of communicating the intentions of policy makers. [10]

[6] Actually, in April, it was the old currency the Austral that was set at 10,000 *australes* to the dollar in the original Convertibility Law (Ley 23.928). In October, the peso replaced the austral at 10000 *australes* or 1 US dollar (Decreto 2128/91).

[7] The original convertibility law stated full coverage; the Central Bank charter (Law 24.144) approved in October of 2001 would establish that one-third could be in the form of dollar-denominated government bonds.

[8] More recently, Neuenkirch and Tillmann (2014) develop a model where inflationary expectations are influenced by deviations of inflation from the announced inflation target. In other words, it lowers the central banker's credibility. Introducing a credibility loss term into the Taylor Rule then introduces another element which the authors find, empirically, to lead to stronger interest rate changes when credibility deteriorates.

[9] There was also substantial debate on the topic during the 1990s and 2000s. Jensen (1997) argued that the reappointment of central bankers raises new credibility issues that limit the positive effect of delegation. Driffill and Rotondi (2006) counter that appropriately defined contracts can eliminate this problem. Keefer and Stasavage (2003) introduce the role of political veto players that can serve to improve the functioning of delegating powers to an independent central bank. Lohmann's (1992) approach suggested that councils should set a rule for policy during normal times with an escape clause for extraordinary shocks, with the driving force being the policy maker's ability to overrule central bank decisions in extreme cases. Mihov and Sibert (2006) show that a monetary policy committee is superior to a single central bank decision maker. Concerns about reputation will induce low inflation policies during normal times, but large shocks will induce a monetary response when necessary. Moscarini (2007) develops a model that shows how accurate information disclosure helps a competent central banker establishes credibility that helps anchor the public's inflationary expectations, thus facilitating improved monetary policy.

[10] In a speech in 2006, Janet Yellen emphasized transparency of policy decisions and timely communication as essential to establishing the Fed's credibility in the United States; however, she called for explicit inflation targeting as an important feature for enhancing that credibility (Yellen, 2006). Forward guidance based on thresholds (e.g., the promise to maintain near-zero interest rates until unemployment falls below a certain level and inflation expectations rise above a certain level) have been deployed in recent years by the Fed (Campbell, 2013). The thresholds point in the direction of state-contingent policies, and as such, can reduce the credibility problem that arises from time

In more practical terms, at the time of the Convertibility Law, there was the perception that to make a "hard peg" exchange rate policy sustainable and avoid the failures of the earlier exchange rate based stabilizations[11], the policy needed to be embedded in a broader institutional structure. The quasi-currency board arrangement was a core part of the institutionalization, as sanctioned in the Convertibility Law. The reform of the Central Bank charter also established preservation of the value of money as the "primary and fundamental mission" of the Central Bank.[12]

While often referred to as the Convertibility Plan, there was not a formal organizing document that laid out a plan. As will be discussed in the microeconomic policy section, associated with the "Convertibility Plan," there was a series of rapid privatization, some deregulation and some opening of markets to external trade. Following the initial boom period, accompanied by a real appreciation of the peso, there was the general recognition that micro-economic reforms were the key to improve external competitiveness, given the inability to conduct a nominal depreciation within the confines of the Convertibility Law.

In terms of fiscal policy, there was no corresponding institutional arrangement similar to the cuasi-currency board arrangement for monetary and exchange rate policy in the early to mid-1990s. Instead, there was a series of laws and agreements focused on intergovernmental fiscal relations, financial management, and reporting and accounting standards. One reform with major fiscal implications was the pension reform that established individual retirement accounts with private institutions managing those accounts. A two pillar system was established with employer payroll contributions flowing to a government administered defined benefit pillar. Employees had the choice of sending their own payroll contributions to either the government administered system or the new private funds (AFJPs). Given that many would choose the private funds, and current pensioners were still paid by the government, there were transition costs on the order of 1 percent of GDP in the late 1990s (Perry and Servén, 2003).

In 1999, with the economy already in a recession and with sovereign spreads rising, Law 25.152 ("Fiscal Solvency Law") established a set path for declining deficits over the following years (1.9 percent of GDP in 1999, 1.5 percent in 2000, etc., declining to 0 in 2003). This particular clause of the law might be considered a one-off deficit targeting exercise; however, other clauses attempted to institutionalize a few basic fiscal rules. For example, a clause established that primary spending could not grow, in real terms, faster than the growth of real GDP. An anticyclical fund was established, with sources of funding specified. The Executive would be required to submit 3 year budget plans to Congress, and debt limits were placed on "below the line" debt accumulation. Provinces and municipalities were invited to promulgate their own fiscal solvency laws in line with the national government's law. Despite these efforts, with the economy falling into deeper recession, deficit targets were missed.

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inconsistency (Kydland and Prescott, 1977). That said, Bodenstein et al (2012) find that the commitment to low interest rates during the great recession in the US and Sweden suffered from low credibility.

[11] See Buffie and Atolia (2012) for an analysis of how weak credibility of an exchange rate based stabilization can lead to high levels of economic volatility.

[12] Belke et al (2014) look at both the independence of central banks and a proxy measure of the policy commitment to establish a measure of the credibility of central bank policy. They find this measure is associated with lower inflation in OECD countries since the 1960s, but the evidence is less strong for developing countries.

Many provinces underwent their own wave of privatizations[13] and pension reforms. The *Pacto Fiscal* of 1992 (Law 24.130) included changes in the revenue-sharing system, and declared a political consensus for launching privatization reforms and the social security reform. The latter was important given governors' influence over their respective provincial representatives in Congress. Without entering into all the details, from a fiscal perspective, the revenue-sharing changes involved the federal government retaining 15 percent from the overall pie of shared resources, while also decentralizing several infrastructure funds and establishing a monthly floor of general block grant revenue-sharing, thus guaranteeing stability to provincial revenue streams. The negotiation of the guaranteed floor would later become an issue of contention during subsequent federal-provincial agreements during the Convertibility crisis. The second *Pacto Fiscal* of 1993 (sanctioned by Decree 14 of 1994) established an agreement on tax reform at the provincial level (e.g., elimination of the stamp tax, agreement on rates for property tax, exemption of the gross receipts sales tax on certain items) while the federal agreement agreed to lower the payroll tax burden and would stop retaining the excess revenue-sharing over the agreed monthly minimum. (The 1992 floor, in practice, had become a ceiling as well.) The federal[14] government also agreed to unify provincial employee pension systems into the national system, so long as provinces reformed those systems to match national norms prior to the transfer.

Federal to provincial transfers represented about one-third of federal government current revenues, or about 6 percent of GDP during most of the 1990s. Provincial fiscal performance varied widely across jurisdictions during the 1990s. Some provinces (e.g., San Luís) ran persistent surpluses while others ran persistent deficits. Some of this variability was due to good management, but also there was great variability in the revenues per capita received across jurisdictions. The distribution of transfers across jurisdictions was locked in place by the Constitutional reform of 1994 and was based on historical norms and negotiation (i.e., there was no formula). On average, the aggregate provincial fiscal deficit was about 1 percent of GDP during the 1990s. One fiscal trend that would be of importance leading up to the 2001 crisis was the evolution of the finances of the Province of Buenos Aires. The fiscal equilibrium of the mid-1990s sharply deteriorated as wage increases and new hiring increased personnel expenditures dramatically and major investments were launched. It is probably not coincidental that the Governor of Buenos Aires was running for President in 1998, and the Governor who followed had presidential ambitions as well.

Fiscal rules, like monetary policy rules, can suffer from time inconsistency problems (Kydland and Prescott, 1977), which may be compounded by political-budget cycle issues (e.g., Rogoff, 1990).[15] There has also been some debate about whether rules or institutions are more important, or are complements. Wyplosz (2012) finds that institutions are helpful, but are not

[13] See Clarke and Cull (2002) for an analysis of the political economy of provincial bank privatization. See Vittas (1997) for an analysis of the political economy of the pension reform.
[14] Note that in Argentina, the term "national government" is used and "federal" is reserved as an adjective for the characteristics of federalism.
[15] Rogoff (1990) shows that rational voters with limited information (in the short-term) about the ability of the government would take the pre-electoral consumption boom as a signal of "competence" and vote for re-election. Streb and Torrens (2013) present a model in which divided government (in terms of political representation in the legislature) can make fiscal rules more credible, given that legislatures need to authorize new borrowing.

necessary nor sufficient for changing fiscal outcomes. The IMF (2013) has found that fiscal councils can discipline macroeconomic forecasts from being overly optimistic in budget processes, especially if those councils have a high degree of independence and media impact. During the 1990s, Argentina never embarked on fiscal rules or strong fiscal institutions that conform to successful examples studied in the literature. That said, fiscal deficits were never particularly large in comparative context (more on this later). At the same time, a case could have been made for more fiscal savings during the boom years.

The cumulative flows of fiscal outcomes accumulate into public debt, or more precisely, net public debt when there are significant public sector assets. Credibility of the government's ability to pay debt is not just a function of the size of that debt – relative to GDP or fiscal revenue—but also the interest rate on that debt and the expected growth rate of GDP and/or revenues. The economy had recovered strongly from the spillover effects of the Mexican crisis in 1995. Over the period 1997-1999, a series of external shocks negatively impacted economic growth in Argentina: the Asian and Russian financial crises in 1997 and 1998 drove up borrowing costs for emerging markets like Argentina, and Argentina's Mercosur trading partner, Brazil, suffered a sharp recession and strong depreciation of its currency. The Asian crisis also had a negative effect on Argentina's terms of trade. As growth slowed and then turned negative in 1999, markets began to reassess whether Argentine debt dynamics were sustainable. The Fiscal Solvency Law of 1999 (mentioned above) attempted to establish a credible path of fiscal adjustment. The credibility of the path, however, naturally depended upon the evolution of economic growth and market interest rates on Argentine debt. The latter had already been shown to be highly volatile during the series of emerging market debt distress over the preceding period.

On the political front, the Peronist Party (*Partido Justicialista*) was split between rival candidates, while the Radical Party formed an Alliance (*Alianza*) with the FREPASO party and successfully won the presidential election in 1999, with President Fernando de la Rúa taking office at the end of the year. The *Alianza* secured a majority in the lower house of Congress, while the Peronists maintained a majority in the Senate.

Attempts to forestall a crisis

The Argentine economy suffered a recession in 1999 with GDP contracting almost 3 ½ percent. The poor performance continued into 2000 with a small contraction of less than 1 percent. The general government fiscal deficit hovered around 4 percent of GDP in 1999 and 2000. General government gross debt rose from 30 percent of GDP in 1997 to 38 percent at the end of 2000.[16] Total external debt had risen from 36 percent of GDP in 1997 to 44 percent of GDP in 2000 (nearly 400 percent of exports).[17] Country sovereign risk ranged from 500 to 860 basis points during the year 2000.

In early 2000, the government secured passage of a tax reform that lowered the exemption threshold on the income tax and lowered deductions for higher income individuals. The tax package included: rate increases on income, excises, fuels, and personal wealth taxes; a broadening

[16] Data from IMF-WEO database.
[17] Data from World Development Indicators.

of the VAT and income tax bases; the elimination of a number of tax incentive schemes for industry and agriculture, and new measures to improve tax administration. The package was expected to generate 0.7 percent of GDP in additional revenues.[18] A labor market reform that would make labor negotiations more flexible and reduce payroll contributions on new hires was also approved (more on this in the microeconomic reform section).

In 1999 and 2000, two new agreements were negotiated among the provinces and the federal government. The 1999 *Compromiso Federal*[19] set a fixed monthly amount of total revenue-sharing with the provinces, rather than receiving a fixed share of a variety of taxes. This fixed sum passed the risk of a decline in revenues to the federal level.[20] The federal government also committed to absorbing any provincial pension systems that had not already been transferred to the federal level. In brief, the political compromise was to give provinces less revenue-sharing than was expected for the year 2000, but in return, the federal government assumed the risks of a further decline in revenues, absorbed some liabilities from provincial pension systems, and promised to assist provincial governments in improving the terms of their debt stocks. The provinces also committed to working with the federal government in coordinating tax administration and fiscal planning. The 2000 *Compromiso Federal*[21] included the agreement to improve transparency and planning of provincial accounts, the use of the new national tax payer system of the federal government, the use of special funds for employment and social programs, and a renewed commitment to agree on permanent new rules for revenue-sharing (*coparticipación*).

On the political front, there had been accusations and rumors of illicit payments to Senators in order to secure approval of the above-mentioned labor reform law. A key plank of the FREPASO party had been a strong stance on anti-corruption. In October of 2000, the FREPASO-affiliated Vice President, Carlos “Chacho” Álvarez, resigned from office sealing an ongoing political rift in the *Alianza*. The political rift clearly called into question whether the institutional basis for setting and implementing economic policy was stable.

In December 2000, given the difficult conditions for access to finance, the government reached an agreement with the IMF and other multilateral lenders to create a financial “shield” (*blindaje*). The announced program was on the order of nearly $40 billion; however, this included $20 billion in general commitments by the private sector to provide financing to the government over the following two years. It is not clear how credible was the commitment from the private sector to contribute nearly half of the announced “shield.” The IMF commitment was for $13.7 billion (using the SDR exchange rate at time of the announcement) along with an expected $5 billion from the World Bank and IDB (combined) and $1 billion from the government of Spain.[22] It was clear that the government was trying to establish a positive confidence shock, given the use

[18] Memorandum of Economic Policies, Argentina program with the IMF, February 14, 2000.
[19] Law 25.235.
[20] See Gonzalez et al 2004.
[21] *Compromiso Federal por el Crecimiento y la Disciplina Fiscal*, Law 25.400.
[22] See IMF News Brief number 00/117, December 18, 2000.

of private sector resources to inflate the "headline" amount of the program, and given the language of the "shield."

The Convertibility Crisis of 2001

There was a temporary recovery in market sentiment in January and February of 2001 (e.g., sovereign spreads declined), but signs of economic recovery flagged. The Minister of Economy resigned in March, followed by a replacement who tried to implement a sharp fiscal adjustment including public sector pay cuts, but he was forced to resign after two weeks. Domingo Cavallo, the father of the Convertibility Plan, entered as Minister of Economy.

One of the measures introduced was a financial transactions tax, as a quick means of generating increased revenue to improve the fiscal balance. The revenues also were not shared with the provinces. A number of other measures affected the definition of the convertibility plan itself. A "convergence factor" was introduced (ratified by Congress in June) that would compensate exporters and tax importers based on the difference between the values of the dollar and the euro (then worth around 0.85 euros per dollar). It was also announced that a correction to the Convertibility Plan (later ratified in June) would adjust the parity of the peso to be an average of the value of the dollar and the euro, once the euro eventually depreciated to more than 1 euro per dollar. It should be noted that the former could be interpreted as a recognition that the currency was in fact over-valued. The latter measure could be interpreted as the admission that there were design flaws in the original Convertibility Law. Argentina did engage in more trade with Europe than the United States, so it was openly discussed that the currency board should always have been pegged to a different selection of currencies, one that reflected more closely the pattern of trade. (In other words, something closer to the nominal effective exchange rate should have been pegged.) That obviously begged the question of the inclusion of the Brazilian Real – especially since its introduction in 1994, subsequent stabilization, and the growing trade flows within the Mercosur customs union. From a credibility perspective, these developments must have raised questions among investors. Sovereign spreads continued to rise throughout the second quarter of the year.

In terms of the political economy of the reforms and institutional conflict, other concerns were raised. The Central Bank President at the time, Pedro Pou, was opposed to the new measures which implied changing the charter of the Central Bank. He was then removed from office, under charges of either involvement in, or neglecting to prevent, money laundering that allegedly occurred at an intervened private bank. Whether the charges were fair or not, the timing of the removal was interpreted by markets to imply a concentration of power in the Ministry of Economy and the violation of independence of the central bank in managing monetary policy (Powell, 2002).

Another key development was the negotiation of a voluntary debt swap with private creditors (local banks and pension funds) in June. The swap would extend the term of debt coming due over the subsequent years, allowing for some financial breathing room. The amount swapped was US$29.5 billion. The implicit interest rate on the operation was more than 17 percent per year.[23] In other words, the transaction validated the extraordinarily high yields prevailing on

[23] IMF (2003).

secondary markets for Argentine debt. At those interest rates, and with the economy in recession, debt sustainability appeared distant. While notionally voluntary, analysis post-crisis would also view this exchange as one of a series of government actions to extract liquidity out of the financial system and pension funds (Mussa 2002; de la Torre et al, 2003).

One of the largest banks in the country, the Bank of the Province of Buenos Aires, owned by the province, had been used by the provincial treasury to finance growing deficits in the years leading up to the crisis. In 2001, the provincial treasury absorbed a portfolio of non-performing loans from the bank in exchange for government bonds.[24] This also represented a deviation from the traditional role of the central bank in banking resolution.

Economic and financial conditions continued to deteriorate. In July, following a short-term debt issue that carried a yield 1410 basis points over US Treasuries,[25] the government announced the Zero Deficit Plan. The plan centered on proportional across-the-board cuts in primary expenditures with the objective of balancing the budget on a cash basis during the second half of 2001.[26] The plan, as approved by Congress, (Law 25.453) also raised the rate on the financial transaction tax that had been introduced months before, raised the rate on payroll taxes for firms in the services and sector, and delayed some other previously enacted tax reductions. With no economic recovery in sight and subsequently falling revenues, investors would wonder whether the target would be met, and also whether the cuts would be self-defeating in terms of leading to a deeper recession.

On the monetary policy front, there was a loosening of the reserve requirements for banks; however, the main developments were outside the realm of official policy. Provincial banks, with no access to borrowing, had started emitting bonds as direct payment to suppliers, or in some provinces, to pay public employee salaries. Local businesses were encouraged to accept the notes and effectively these notes circulated as a quasi-money. The federal government, through the government-owned *Banco de la Nación*, also introduced notes for payment of revenue-sharing to provinces that could then be used by the provinces to pay wages and other expenses. They could also be used by eventual recipients to pay federal taxes. Unlike some of the provincial monies, these notes explicitly did not pay any interest. By December of 2001, these quasi-monies had grown to the point where they represented 26 percent of the stock of pesos in circulation.[27]

The IMF disbursed $6.2 billion in early September. In the following months, however, there was a declining degree of support from the IMF, and from US Treasury officials (based on public statements).[28] In October, discussions were underway for a $100 billion debt restructuring with official support from the IMF and the United States Treasury. These discussions never met a successful conclusion.

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[24] IMF Letter of Intent, Memorandum of Economic Policies, Technical Memorandum of Understanding, August 30, 2001.
[25] See the summary timeline of events in De la Torre et al, 2003.
[26] IMF Letter of Intent, Memorandum of Economic Policies, Technical Memorandum of Understanding, August 30, 2001.
[27] De la Torre et al, 2003, table 9.
[28] See the summary timeline of events in De la Torre et al, 2003.

Meanwhile, deposits in the banking system had been shrinking all year, as were international reserves, as many depositors converted their accounts into dollar cash. Deposit withdrawals accelerated sharply during November. On December 2nd, a partial freeze on deposit withdrawals was announced – the now well-known *corralito*. Withdrawals were limited to 250 pesos or dollars per week. A couple of weeks later, with widespread pot-banging protests in the streets (the *cacerolazos*), the entire cabinet resigned, and the following day, the President resigned. Over the holiday period, there were two interim Presidents. The second was in office long enough to announce the suspension of external payments and the creation of a new currency, outside the realm of the Convertibility regime. On January 2 2002, Eduardo Duhalde was sworn in as President to serve the remainder of De la Rúa's term.

What went wrong? There has been a large literature that emerged following the demise of the Convertibility period that offered explanations as to what caused the crisis and whether it was avoidable. One analysis summed it up as a mixture of "bad luck, bad management, bad politics and bad advice" (Powell, 2002). Others argued that the crisis was almost inevitable given the external shocks, hard peg exchange rate of the currency board, dollarized liabilities, and dependence upon external finance (Hausmann and Velasco, 2002). Some placed greater emphasis on the role of an overvalued exchange rate (Perry and Servén, 2004), combined with pro-cyclical fiscal policy and currency mismatches from non-tradable sector borrowing in dollars. De la Torre et al (2003) called it a currency-growth-debt trap. Calvo and Talvi (2005) highlighted the phenomenon of a "sudden stop" in capital flows following the Russian crisis that interacted with Argentine characteristics: a high degree of liability dollarization and a relatively closed economy. Others (della Paolera and Taylor, 2003; Rojas-Suarez, 2002) placed the blame on traditional crony capitalist behavior by the banking system.[29] As the crisis unfolded, given the obvious costs of exiting the currency board in the middle of the crisis, the authorities decided to "double their bet" on what was always an inherently risky arrangement (Galiani et al, 2003).

For the purposes of this paper, the history of policy credibility and political support provide important lessons for policy making today. The adoption of a currency board can be thought of as either importing credibility (virtually adopting the currency of another country) or signaling credibility via a central bank charter with clear and stringent rules. The rapid decline in inflation resulted in political support from the lower deciles of the income distribution, given that they paid the highest burden of the inflation tax. The privatization process of the early 1990s also opened up new business opportunities (as well as possible abuse) for domestic and foreign investors. External conditions favored economic growth as well during the early years of the Convertibility Plan. Political support carried President Menem to reelection in 1995 with a nearly 20 percentage point margin of victory, despite the recession, financial stress and sharply rising unemployment. The economy recovered strongly with external conditions (terms of trade, financing conditions) improving.

[29] Calomiris and Powell (2000) took an opposing view on the role of the financial system by documenting the inherent strengths of the financial system, its regulatory system, and its resilience to external shocks throughout the 1990s.

One issue is the lack of fiscal institutions to save during good times, reduce debt, and establish greater credibility of debt repayment during bad times. The federal system with important subnational expenditure responsibilities but limited subnational revenue responsibilities also hampered incentives for fiscal probity at the subnational level.[30] Federalism and national politics interacted through the use of regional distribution of funds and/or regional pattern of reforms to secure support from small, over-represented provinces to establish coalitions for reform (Gibson and Calvo, 2000; Calvo and Murillo, 2008).

On the side of monetary policies, as the situation deteriorated in 2001, the government may have "doubled its bets" on the convertibility plan, but it also sent mixed signals as it tweaked the currency board at the margin ("fiscal" devaluation and introduction of the euro) and tinkered with the institutional arrangements (questionable dismissal of the Central Bank president). One issue that is often under-emphasized in the "post-mortems" of the crisis is the double digit unemployment rate that emerged in the mid-1990s and persisted even during the post-Tequila crisis growth period. As established in a classic paper,[31] signaling a tough stance on an exchange rate peg can actually lower the future credibility of that pledge in the face of persistently high unemployment.

What would a credible policy package have looked like to avoid the crisis? It is not at all clear. Recall the three criteria laid out in the introduction: (i) the policy has internal logic and rationale and appears to have the right magnitude to achieve its goals; (ii) the policy is based on reliable data and trusted institutions; and (iii) the policy is consistent with a longer-term vision or strategic direction. On the fiscal policy front, there was great uncertainty as to whether a fiscal contraction could create a confidence shock sufficiently large to reassure the private sector. Some argued that a fiscal expansion might have worked; however, given the soaring bond spreads and declining confidence, it would have been a highly risky proposition at best.[32] In terms of fiscal policy, determining the right magnitude or even the right direction was highly speculative. There was reliable data; however, political and administrative institutions were losing credibility throughout the year, as discussed above. Some have suggested that a shift in strategic direction was needed, perhaps abandoning the currency board or moving to full dollarization. Perry and Servén (2004) suggest that the currency board should have been abandoned to allow for real exchange rate flexibility, but this should have been done in 1997 or early 1998 when the economy was still growing. De la Torre et al (2003) suggested that one way out might have been dollarization of the stocks of assets and liabilities with "pessification" at the margin with the gradual introduction of a new currency outside of the convertibility regime. This gradual approach might have worked – at least as a preferred form of crisis resolution – but might not have avoided the currency crisis itself. In brief, with so much of the credibility of macroeconomic policy riding

[30] See Saiegh and Tommasi (1999) for a transactions cost analysis of subnational finance in Argentina.
[31] See Drazen and Masson (1994). The model deviates from earlier signaling models where policy makers signal their "type" by taking a strong stance. Instead it is the policy itself, rather than the policy maker, that loses credibility over time when negative economic conditions persist. The authors test their model for countries participating in the pre-Euro fixed exchange rates of the European Monetary System (EMS).
[32] The IMF's own retrospective looked into this possibility that a fiscal expansion might have improved the situation. Their empirical estimates show that it would not have worked. See IMF (2003), Box 9.

on the currency board regime itself, it is not at all clear that there were any credible alternatives to avoiding the 2001 crisis.

Post Convertibility to the Present

In January, 2002, President Duhalde reiterated the moratorium on debt payments and the end of convertibility. A dual exchange rate system was then established (with Congressional approval) with an official exchange rate of Arg$1.4 per U.S. dollar for public sector and most trade-related transactions, while market exchange rates would be used for all other transactions. At the same time, the monthly deposit withdrawal limit was raised to 1,500 pesos, but term-deposits were frozen, and dollar deposits were declared frozen until at least 2003. To ease inflationary pressures from the depreciation, prices of utilities (gas, electricity, telephones and water) were frozen indefinitely.

Assets and liabilities of the banking system were converted back to pesos, but at asymmetric exchange rates. Loans to the private sector were converted at the old parity rate of one dollar-one peso. The rationale was to protect firms and households (e.g., mortgage holders) from facing bankruptcy – given that most earned their incomes in what would soon be rapidly depreciating pesos. Loans to the public sector were converted at the official rate of Arg$1.4 per dollar. The official rate was also used for U.S. dollar deposits, which were also indexed to inflation. Naturally private sector loans that had been funded out of dollar-denominated deposits now opened large negative net worth positions for banks. Eventually bonds were offered to banks to compensate for these losses.

The market exchange rate soared towards 4 pesos per dollar, but stabilized around 3.5 pesos per dollar by the end of the year. The depreciation, combined with compensation bonds to banks and accumulated arrears to external creditors, raised the public debt ratio from 63 percent of GDP at end-2001 to about 135 percent at end-2002.[33]

The economy shrank precipitously in the first quarter of 2002, and then began to gradually recover. Overall, the cumulative decline in GDP over 1999-2002 was about 20 percent. The unemployment rate hovered around 18 percent during 2001 and 2002. Banks were in fragile condition, international reserves had dwindled to critically low levels, and the government remained heavily indebted. These were indeed dire times from a macroeconomic perspective, with dire social consequences.

Monetary policy focused on providing liquidity to banks during the early months of 2002, but also sterilizing those liquidity injections in order to limit the pass-through of the devaluation to inflation. End-of-period annual inflation was 41 percent.[34] A much feared bout of hyperinflation had been avoided.

Fiscal policy took advantage of the renewed inflation to reduce real primary expenditures by 28 percent[35] while nominal revenues grew, boosted by inflation. On the revenue side, taxes on commodities exports were introduced (and not shared with the provinces). A primary surplus of

[33] IMF (2003).
[34] IMF December 2003 Staff Report on Argentina
[35] *Ministério de Economia* (2003).

0.9 percent of GDP (cash basis) was achieved for 2002. With domestic demand depressed, the external current account surplus soared to nearly 10 percent of GDP (including interest on non-performing debt, but not interest on arrears).[36]

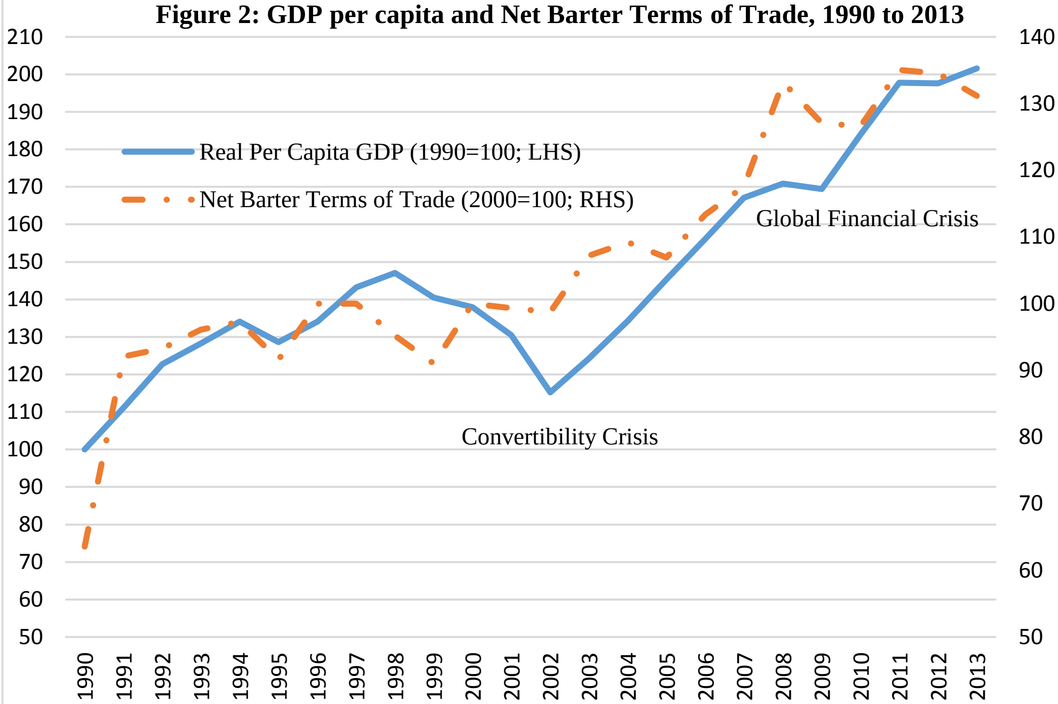
In broad terms, macroeconomic policy was "conservative" in terms of regaining control of the money supply, bringing down inflation and increasing primary surpluses.[37] This process continued through 2003. External conditions also began to improve, in 2003, as the terms of trade (See Figure 2 and Table 2) began to improve sharply. In addition, the removal of the burden of external debt service payments also assisted the recovery. Economic growth reached nearly 9 percent in 2003. In May of that year, President Nestor Kirchner entered office under these favorable conditions. Consumer confidence also soared, as displayed in Figure 3.

Table 2: Basic Macroeconomic Indicators, 1980-2014, % (period averages)

	1980-1991	1992-2001	2002-2014
Inflation	744.3	3.6	12.5*
GDP growth	0.0	2.8	4.4**
Terms of Trade	83.9	96.4	120.0

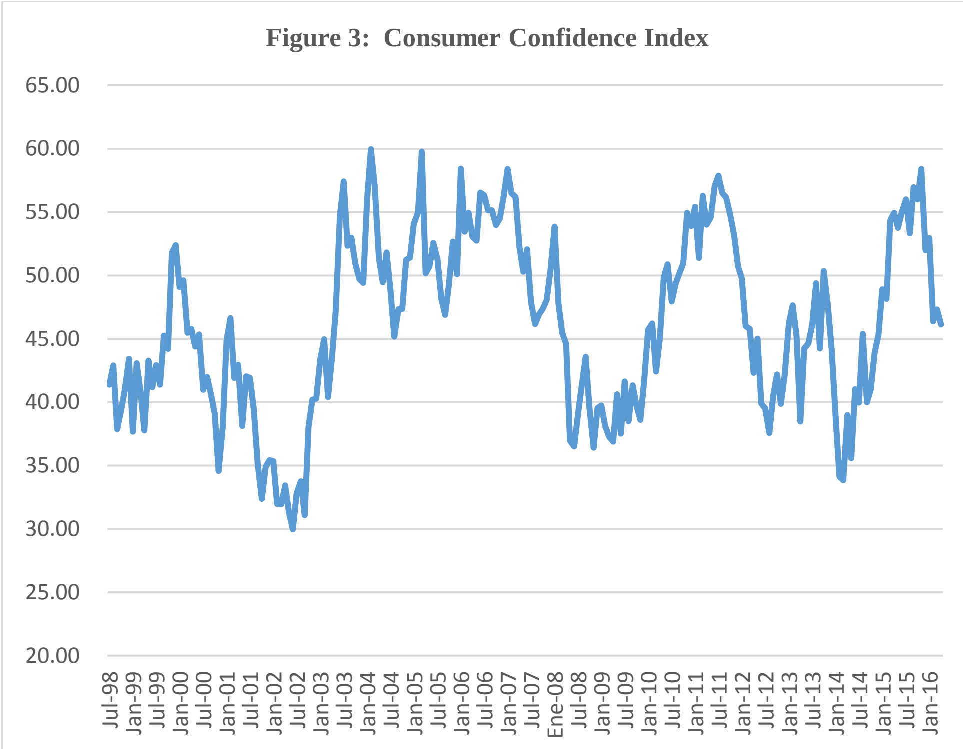
*Disputed data in recent years.
**5.7 percent, excluding 2002.
Source: WDI and WEO databases.

Figure 2: GDP per capita and Net Barter Terms of Trade, 1990 to 2013



Source: World Development Indicators, author's calculations

[36] IMF December 2003 Staff Report on Argentina.
[37] Buera et al, 2011, highlight this period as one of two brief periods where fiscal management and growth performance rose above the slower trend post-1974.



Source: di Tella Institute's "ICC"—Índice de Confianza del Consumidor. The index for the capital Buenos Aires was used, since it dates back to the late 1990s (for comparison sake). The last observation is April 2016.

Economic growth was on the order of 9 percent each year over 2003-2005. Inflation was brought down to the single digits in 2003 and 2004, but accelerated in 2005. Fiscal policy retained surpluses, and monetary policy was broadly consistent with inflation objectives. The exchange rate stabilized and stayed below 3 pesos per dollar, with sustained current account surpluses. It should be noted that favorable fiscal results were also dependent upon export and financial transaction taxes (not shared with the provinces) that together comprised about 1/5 of federal tax revenues.

One important policy development in 2004 was the passage of a Fiscal Responsibility Law. The law (25.917) established a ceiling on provincial debt service of 15 percent of current revenues (net of transfers to municipalities). If a province's debt service were to pass the limit, the province was required to present plans of primary surpluses that would lower the debt burden to levels compatible with the debt service limit. Provinces that were not in compliance could no longer borrow, other than to roll over existing debt. It also established a federal fiscal council for coordinating fiscal policy across the levels of government, set standards for reporting fiscal accounts on an accrual basis, and called for the explicit accounting of tax expenditures and fiscal guarantees. Note that no quantitative targets or guidelines were established for the deficit or debt of the federal level of government.

In 2005, the government successfully launched a global debt exchange on $82 billion in claims. The offer implied a net present value haircut of about 75 percent. About 76 percent of

bondholders accepted the offer.[38] The government then resumed payment on debt – except for the holdout debt—and sovereign spreads dropped from the astronomical levels (over 5000 basis points) that prevailed during the payment moratorium period.

During 2005, the government still faced financing constraints. In order to close a financing gap of $6.5 billion, the government resorted to extraordinary financing sources, "….including placing public-sector bonds with the tax collection agency (*Administración Federal de Ingresos Públicos*, AFIP), the social security system (*Administración Nacional de la Seguridad Social*, ANSES) and other public sector funds holding excess liquidity. The authorities also sold bonds to the government of the República Boliviariana de Venezuela and the province of Santa Cruz" (EIU Country Report March 2006). The use of ANSES for liquidity would foreshadow later events.

In terms of international relations and macroeconomic policy, the government made an early payment of $9.6 billion to cancel its obligations to the IMF in January 2006. An Article IV Consultation was completed in July 2006, but the staff report was never published. Since then, there have been no Article IV consultations, and in this regard, Argentina is not in compliance with its membership agreement with the IMF.[39]

Leading up to the presidential elections in October 2007, the economy was still growing at 8 percent. Inflation had been accelerating. In January, the government intervened in the national statistics agency (INDEC). Since then, there has been a credibility cloud over the official inflation data, and private agencies started publishing alternative data. With accelerating inflation, the government engaged in price control negotiations with major retailers and used export taxes to keep the supply at home of goods with rapidly rising prices.

Nestor Kirchner's wife, Cristina Fernandez de Kirchner, won the 2007 presidential election with 45 percent of the vote, 20 percentage points ahead of the second-place candidate in a crowded field. During much of her first administration, however, it was generally considered that her husband retained substantial power in formulating policies and coordinating political strategies.

Over the 2008-2009 period, the economy suffered the consequences of the emerging global financial crisis with growth decelerating to 3 percent in 2008 and then 0 percent in 2009. On the policy front, the extraordinary government financing maneuvers continued with the seizure of $30.2 billion in assets of the private pension funds.[40] In addition to these assets, a new flow to the government pension agency (ANSES) would then be established from the payroll contributions that had been flowing to the private funds. The government also increased export taxes, sparking protests (*cacerolazos*) and farmers' strikes.

In 2010, the government offered a new bond exchange for the remaining holdouts. The two-thirds adherence by this group lowered the remaining share of holdouts to only 7 percent of

[38] IMF Article IV Staff Report, July 2005.
[39] Dreher and Voigt (2008) find an association between membership in international organizations and credibility, where country risk ratings is the proxy. The stand-off with the IMF cast doubt on Argentina's status as a member in good standing of a key international organization.
[40] Arza (2009).

the original bondholders. Despite the bond exchange, sovereign spreads hovered around 700 basis points during 2010-2011. In December 2010, the economy minister invited an IMF technical assistance mission to visit Argentina and help INDEC set up a new national consumer price index. (With the prior intervention in 2007, the national index was suspended and only Buenos Aires regional prices were published.)

The re-emergence of a traditional electoral budget cycle occurred during 2010-2011, leading up to the 2011 presidential election. Monetary policy was accommodative as well, with resulting inflation over 20 percent in the period, according to private sector estimates. Capital flight with speculation over a devaluation of the official peso rate (with a substantial premium in the "blue" market) led to additional foreign-exchange and capital controls.[41] The economy grew rapidly and Ms. Kirchner was re-elected in October with 54 percent of the vote, the highest since the return to democracy in 1983.

Growth slumped over the 2012-2014 period, averaging just under 1 ½ percent. During 2012 there was a series of economic policy measures that generated controversy. In February, with continued pressures on reserves and the exchange rate, the government imposed a restrictive import licensing arrangement, sparking a complaint by the United States, European Union and Japan at the WTO. In March, a new Central Bank charter established new multiple objectives: "…in the framework of the policies established by the national government, monetary stability, financial stability, employment, and economic development with social equity."[42] The new charter also granted broad authority to regulate interest rates and loan conditions in the financial system, and it opened up the scope for automatic advances for financing the government budget.[43] In April, the government nationalized the YPF-Repsol oil company, along with other measures affecting energy and infrastructure sectors (more on this in the next section).

On the political front, in late 2012, there was a 24-hour general strike led by the CGT workers' union. With accumulated inflation and nominal wage increases soaring, the lack of inflation adjustment to minimum income tax thresholds implied increasing tax burdens. Political tensions continued into 2013 and the Kirchner political movement fared poorly in the mid-term congressional elections.

There were some overtures to foreign investors during 2014. The government agreed to compensate the Spanish Repsol oil company for the nationalization of YPF. The government also reached agreement with "Paris Club" official creditors on a timeline for clearing debt arrears.

A major negative external event in 2014 further complicated macroeconomic policy making. A New York Court ruled that Argentina must pay a holdout creditor in full, before servicing debt on exchanged bonds from the 2005 and 2010 restructurings. Despite exploring alternative forms and locations for servicing the debt, Argentina returned to default status on external debt. Subsequent negotiations failed to reach agreement with the holdouts.

[41] EIU Country Report, Argentina, December 2011.
[42] Article 2 of Law 26.739.
[43] Article 9 of Law 26.739.

In 2015, with presidential elections approaching, the economy stagnated, inflation remained high, and foreign exchange pressures continued. Fiscal policy remained without a clear medium-term framework and without quantitative fiscal rules at the federal level. Political budget cycles re-emerged. Monetary policy had multiple and expansive objectives and central bank financing of the government was institutionalized. The broader framework, or direction, for macroeconomic policy making was unclear, other than general political statements on "not repeating the mistakes of the 1990s." Even understanding the size of fiscal and monetary problems was difficult, given doubts about macro statistics, and increasing use of off-budget fiscal mechanisms. In terms of the definition of credibility, and the characteristics of credible policy, outlined in the introduction, the path forward on credible macroeconomic policy could be challenging, to say the least.

IV. Microeconomic policy

In this section, a brief historical survey will be organized by sector, or policy area, rather than chronologically. The areas covered are: trade and foreign investment; business climate; labor markets; financial markets; public utilities; and the new "supply law." Social sector policies have a critical role in both economic performance and socioeconomic outcomes, as well as the political economy of reform; however, they are beyond the scope of this paper.

Trade and foreign investment

Argentina is a member of the Mercosur customs union, which started functioning in 1994, and Argentina is a member of the World Trade Organization (WTO) since its inception in 1995. There continue to be long lists of exempted goods within Mercosur, so that it does not function as a true customs union. Common tariffs on manufactured goods remain high, compared to other emerging market economies. External trading partners also note high costs associated with customs clearance.[44] Argentine non-tariff measures have increased in recent years, as noted above, in the macroeconomic policy section. More specifically, the current dispute before the WTO concerns:

- The procedure connected to the Advance Sworn Import Declaration (*Declaración Jurada Anticipada de Importación*, DJAI), required by the Argentine Government since February 2012 for most imports of goods into Argentina; and,

- The imposition by Argentine authorities on economic operators of one or more of the following trade-related requirements (TRRs) as a condition to import into Argentina or to obtain certain benefits: (a) to offset the value of imports with, at least, an equivalent value of exports; (b) to limit imports, either in volume or in value; (c) to reach a certain level of local content in domestic production; (d) to make investments in Argentina; and, (e) to refrain from repatriating profits. The requirements are in some cases contained in

[44] See "Assessment of Barriers to Trade and Investment between the EU and Mercosur," May 2011, Copenhagen Economics prepared for the European Commission, DG Trade.

agreements signed between economic operators and the Argentine Government or in letters addressed by economic operators to the Argentine Government.[45]

The dispute panel has ruled in favor of the complainants. Argentina has requested reasonable time to respond to the dispute panel's recommendations.[46]

The literature on trade openness and growth has a long history and with mixed results.[47] Like many policy actions, the role of complementary policies may be key to reaping the full rewards from trade opening. Chang et al (2009) find that "Openness can be good for growth," but the impact is a function of structural policy characteristics, like educational investment, financial depth, inflation stabilization, public infrastructure, governance, labor market flexibility, ease of firm entry, and ease of firm exit. There is also a long literature – both theoretical -- on trade policy uncertainty and the impact on investment.[48]

In broad terms, the legal status of foreign investment itself is transparent and non-discriminatory.[49] Foreigners can invest "on an equal footing" with domestic companies without prior government approval. Foreign investors have the same rights and protections as domestic investors and can invest in any sector. That said, "(t)he government also has adopted a tougher stance against some new foreign companies, for example, by requiring that such firms provide information to government about their shareholders."[50]

Foreign exchange controls and export taxes, however, can hinder foreign investment. Most foreign investors are concerned about whether they can repatriate profits or withdraw investment when business prospects change. Restrictions on the movement of foreign currency and non-market based "official" exchange rates create risks for foreign investment. Export taxes are focused on certain agricultural commodities. The sudden imposition of such taxes, or increases in their rates, can be viewed by investors as a form of expropriation.

International investment treaties can help convince investors that property rights will be respected for foreign investors, with clear processes for dispute resolution (for example, through the International Center for the Settlement of Investment Disputes (ICSID)). Allee and Peinhardt (2011) find empirical evidence that the signing of such treaties does raise the level of FDI, but only if the countries do not suffer subsequent disputes at ICSID. The latter signal a lack of credibility in the compliance with the signed treaties.

More generally, the wave of nationalization of commercial enterprises and pension funds in Argentina raises additional questions of expropriation risk. There is also the problem of potential unfair competition from favored (or subsidized) state-owned enterprises (e.g., oil or

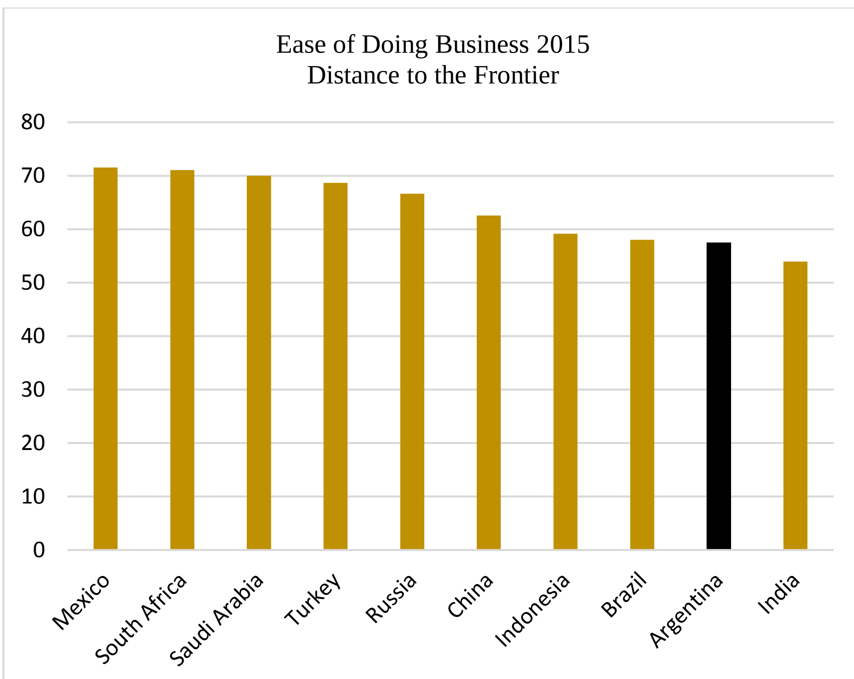
[45] Exact wording from Dispute Settlement DS444 posted on the WTO website.
[46] Davey (2014) reviewed WTO disputes over the first 10 or 12 years of the WTO and found that about 80-85 percent were implemented.
[47] See, for example, Dollar (1992), Sachs and Warner (1995), and Edwards (1998), Frankel and Romer (1999), Harrison (1996) and Rodriguez and Rodrik (2001).
[48] See Bassanini (2006) for a model tailored to the circumstances of developing countries. Also see Handley and Limão (2012) for a model with empirical evidence based on firm level data in Portugal.
[49] See Deloitte, "Taxation and investment in Argentina 2014: Reach, relevance and reliability."
[50] Ibid, page 2.

banking sectors). In addition, import restrictions can hurt businesses that need imported inputs. Sanchez-Martin et al (2014) find expropriation risk and trade openness have an effect on FDI flows in Latin America. Actions that target particular sectors (export taxes) or firms (nationalization) reduce microeconomic credibility, as defined in the introduction of this paper. Brunetti et al (1998) use a survey of entrepreneurs to develop a measure of policy credibility and find a significant correlation with economic growth and investment.

Business climate

One summary measure of the business climate is the Ease of Doing Business aggregate from the annual Doing Business report.[51] As in the macroeconomic performance section, a useful set of comparator countries is the emerging market members of the G20. Figure 3 below reports the "distance to the frontier" measure rather than the ranking. The distance to the frontier is how close the country's performance is to the leading country in that indicator. In other words, Mexico's score in figure 4 is a little over 70 percent of the leading country. This becomes particular interesting when one looks at subcategories of doing business (See Annex 2). It should be noted that many of the subcategories are based on the analysis of legislation in the particular area; i.e., the *de jure* regulations. One issue related to government credibility is the degree and consistency of *de facto* enforcement of *de jure* regulations.

Figure 4: Doing Business 2015, Comparison to G20 Emerging Markets



Source: Doing Business database, 100 represents the score of the leading countries.

Figure 4 shows that the emerging markets of the G20 lag substantially behind the global leaders. In relative terms within the group, Argentina lags about 15 percent behind leader Mexico.

[51] Also see World Bank (2005) for a discussion of the investment climate more generally.

Fajnzylber et al (2009) find that investment climate variables have a significant effect on growth and productivity in LAC, and Loayza and Servén (2010) find similar results globally.

Labor markets

In the early to mid-1990s, Congress passed two labor reform laws. In 1991, a reform introduced fixed-term contracts and special-training contracts for young workers.[52] In 1995, a second reform introduced a trial period for all contracts, established special contracts to promote the employment of certain age groups, and a special, more flexible labor regime for small firms.

In 2000, shortly after entering office, the de la Rúa regime secured passage of a labor reform law, as noted above in the macroeconomic section. The new law allowed large companies to increase the prevailing 30-day probationary period for new hires to six months. Small businesses could extend the probationary period to one year. During the probationary period, workers could be dismissed without benefits. Payroll taxes on newly hired workers would be reduced to 12 percent from 17.5 percent.[53] Compensation for unfair dismissal was also simplified and dismissal notice periods were reduced from 30 to 15 days. Collective bargaining was decentralized substantially: "….the monopoly of representation granted to unions with *personería gremial* (legal recognition) was maintained, but first- and second-degree organizations (unions and federations) could delegate negotiation power to local representatives, consecrating the decentralized collective bargaining process." [54]

In 2004, the law from 2000 was revoked by Article 1 of Law 25.877. Despite the outright revocation of the earlier legislation, the new law laid out measures that were not all completely different from the earlier law. For example, the probation period was set for 3 months – somewhere in between the six months of the 2000 reform and the 30 days preceding the 2000 reform. Firms with 80 workers or fewer were granted a reduction in payroll contributions. Firms with more than 300 workers have to present a "social balance"--describing working conditions, the status of the firm, etc.,--thus imposing new burdensome reporting requirements.

Since 2004, there have been a number of additional labor-related reforms, mostly intended to regularize informal sector workers. Law 26.476 of 2008 exempted firms from paying any fines for registering up to 10 previously informal workers. For firms regularizing more than ten workers, the conditions for paying fines and back taxes were established. Following that law, there were a number of resolutions and decrees to provide details on precisely how fines would be levied when regularizing workers. In 2014, Law 26.940 established a public registry of employers under sanction from the Ministry of Labor for failing to register workers, failing to pay payroll contributions in full or failing to comply with other legal labor standards.

In recent years, there has been renewed debate about labor reforms. For example, under consideration is raising the number of days that fathers have for paternity leave from 15 days to a higher number. There is also debate about raising the minimum termination benefits for workers.

[52] See Hopenhayn, 2004.
[53] Law 25.250.
[54] Cardoso and Gindin, 2009, page 5.

Financial markets[55]

With the aftermath of the 2001 financial crisis, the depth of the Argentine financial system has shrunk. From 2001 to 2011, private credit by deposit money banks declined as a share of GDP from 22.4 percent to 13.5 percent, and their assets to GDP has shrunk from 33 percent to 22 percent over the same period. Stock market capitalization has plummeted from 67 percent of GDP to only about 12 percent. That said, access to financial institutions is relatively high compared to upper-middle income countries, in terms of the number of bank accounts, the percentage of firms with checking accounts and other standard indicators. Most indicators of financial institution efficiency are in line with upper-middle income country standards. In terms of stability, financial institution stability (e.g., non-performing loans) is strong; however, stock market volatility is extraordinarily high.

One of the key issues for financial depth and for the cost of borrowing is the macroeconomic situation. Base rates remain extremely high by international standards, which combined with sovereign spreads, puts a floor on interest rates.

Public utilities

During the 1990s, there was a wave of privatization of public utilities and infrastructure services (e.g., road concessions). The major electricity, gas and water companies passed to private hands, often with substantial foreign investment. The convertibility regime implied that dollar denominated investments earned dollar denominated returns. In 2002, the Economic Emergency Law was passed giving broad powers to government to re-negotiate contracts. Utility prices were frozen through 2003. Over time, the regulation of these utility prices was used to dampen inflation.

The process of contract renegotiation proceeded very slowly. For example, in March of 2006, the Economist Intelligence Unit reported:

> The government has also postponed all tariff increases for public utilities because of the worsening inflationary outlook. These had already been delayed for electoral reasons until after the October 2005 congressional elections. The extension for one year of the Economic Emergency Law in December has given the government additional breathing space. One of the provisions of the law authorises the executive to re-negotiate contracts with privatised public utilities. Out of a total of 47 re-negotiations of contracts with owners of privatised utilities broken in 2001-02, only one (that of an electricity distributor, Edelap) has been concluded and implemented. The government may well continue to authorise higher public utility rates for medium-sized and large consumers, but will probably postpone any increase for residential consumers. In other areas, such as transportation, the government is likely to continue granting subsidies to private-sector operators rather than granting rate increases. Apart from reducing private-sector utilities' profitability, postponing rises in utility prices has discouraged new investment. -EIU Argentina Country Report, March 2006.

In 2006, the government nationalized the water company of the greater Buenos Aires region. For the electricity sector, public feuds have continued between the government and the still private electricity companies over blackouts and pricing. Some subsidies were reduced for

[55] Data used in this subsection are from the *Global Financial Development Report 2014*.

large firms; however, during 2013, "Government spending on energy subsidies rose almost 72% on the year to 60 billion pesos ($9.15 billion) between January and September, according to estimates by ASAP, a nongovernmental organization dedicated to improving public-sector finances."[56]

New Supply Law (Ley 26.993)

One overarching microeconomic policy consideration is the state's ability to fix prices of consumer goods. With the new "supply law" of 2014, consumers were empowered to file complaints of price gauging by firms. In setting up the regulations of the law, in 2015, a supply monitoring system was established to be an early warning mechanism for supply shortages of basic goods. Large firms are required to report to the system. The new law opened wide scope for government intervention (price setting or goods confiscation) when judgments are reached against firms.

V. Macro-micro linkages and the political economy of future reforms

Based on the historical survey above, there appears to be a macroeconomic dominance to the credibility of broader economic policy-making. Emerging from the hyperinflation of the 1980s, the top priority was stabilization. Once the decision was made to adopt the quasi-currency board arrangement, two problems emerged. First, to achieve macroeconomic consistency and credibility: fiscal institutions needed to be strengthened through a combination of fiscal rules, fiscal councils and reform of intergovernmental fiscal arrangements. Secondly, the only credible microeconomic approach that would assure growth would be to strive for flexible wages and prices via the liberalization of goods and factor markets. In other words, given the macro rules of the game, there was really only one credible path for microeconomic reform. Some authors cited above have argued that not enough was done on privatization, price liberalization and opening to international markets. Others have argued that internal devaluation through nominal and wage and price adjustment is almost impossible to achieve even in the most "liberalized" economic setting, and it is almost certainly *politically* infeasible. If the latter is true, the overall convertibility scheme was never truly credible in the first place. Either way, when the "father" of convertibility began to tweak the definitions of the currency board during 2001, it was pretty clear to many economic agents that the end was near. To avoid the risk of "argen-dollar" denominated assets being converted into devalued pesos, it was better to convert to real dollars and take them overseas.

Similarly, during the post-Convertibility period, many actions on microeconomic reforms seem to have been driven by macroeconomic necessities. Broadly conservative macroeconomic policies initially were used to stabilize the exchange rate and bring inflation down to the single digits. On the other hand, they were also complemented on the micro level by price controls, in particular of public utilities. Macroeconomic policy was never fully institutionalized. For example, the fiscal responsibility law placed debt service limits on the provinces, but not on the federal government, and even at the provincial level, implementation was flawed. Monetary policy became subject to fiscal financing demands, with institutionalized monetary finance of

[56] Wall Street Journal, January 3, 2014, "Argentina continues fight with utilities after power outages: Government repeats threats to revoke concessions of two companies serving Buenos Aires."

government deficits in the new Central Bank charter. With limited access to finance, microeconomic maneuvers could raise revenues and provide government finance: for example, export taxes[57] and pension system unification. With scarce foreign exchange pressuring the exchange rate and consequently inflation, the answer was to impose import restrictions to economize on foreign exchange. More recently, with inflation pressures persisting, the new supply law opens the scope for more direct price controls. In each case, macroeconomic pressures seem to drive microeconomic reforms. In terms of microeconomic incentives, many of the above actions can be seen as a violation of property rights. From a growth diagnostics perspective, these actions can create a binding constraint to growth through the risk created by the inability to secure property rights for one's investment and returns on that investment.[58]

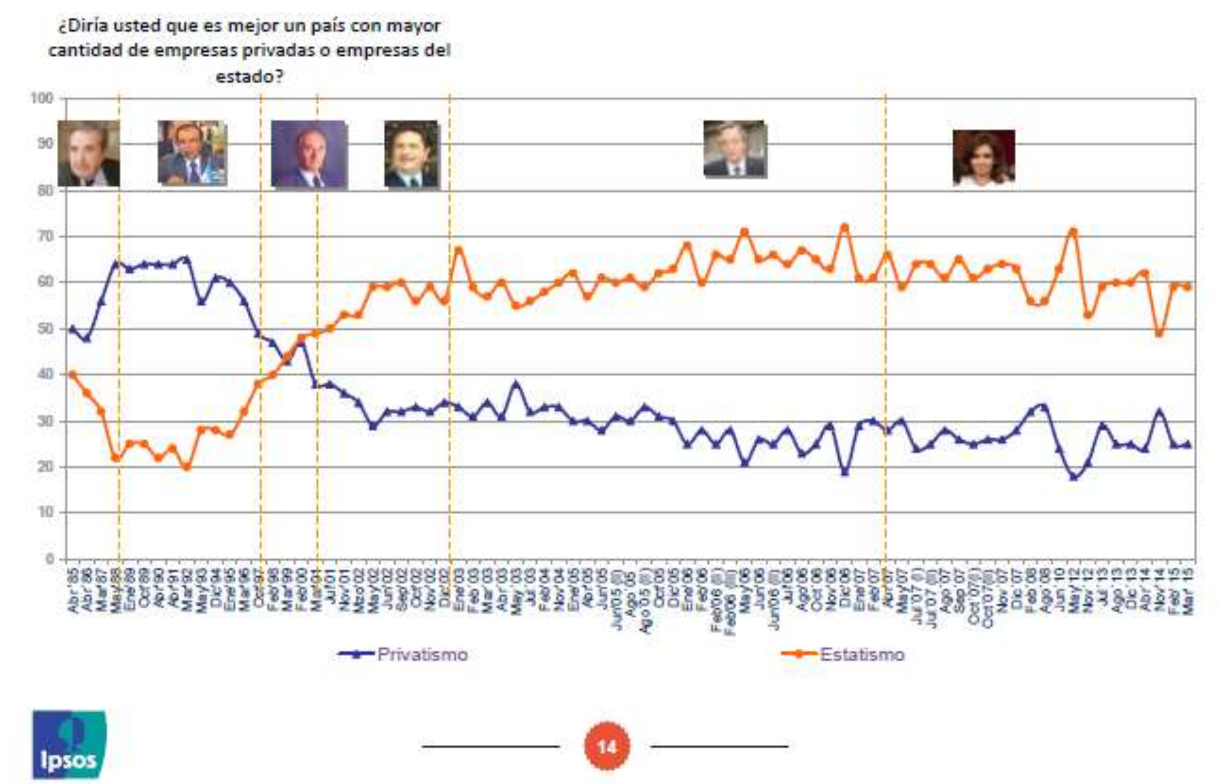
Policies are also driven by politics. As mentioned above, in the early 1990s, the end of hyperinflation delivered a big boost to low income families, and privatizations opened business opportunities for large corporations. In addition, exchange rate appreciation and the reduction of tariffs made it more affordable for the middle-class to buy foreign consumer goods. One growing political weakness was sharply rising unemployment in the mid-1990s. It is interesting to note the changing attitudes of Argentines about state versus private ownership of enterprises. Figure 5(a) below shows that there was a period in the 1990s when most Argentines thought it was better to have a country with more private than state-owned businesses. The difference was wide (about 40 percentage points). Since the early 2000s, the situation is exactly the opposite, and the lines cross in the middle of the convertibility crisis. One should note, however, that the tendency started changing back in 1995—when the unemployment rate had hit 18 percent (Figure 5(b)). Political support for the direction of microeconomic policies may have already been eroding. Also, there may have been an increasing perception that the reforms of 1990s had benefited certain groups more than others, due to rising inequality. Certainly, the unemployed were not benefiting. These economic circumstances and related perceptions of unfairness may have undermined the legitimacy of the administration.

[57] There could have been a coherent rationale for windfall profit taxes during the commodity boom. The revenues could have been partially saved for an eventual decline in commodity prices and partially invested in areas that could promote export diversification.

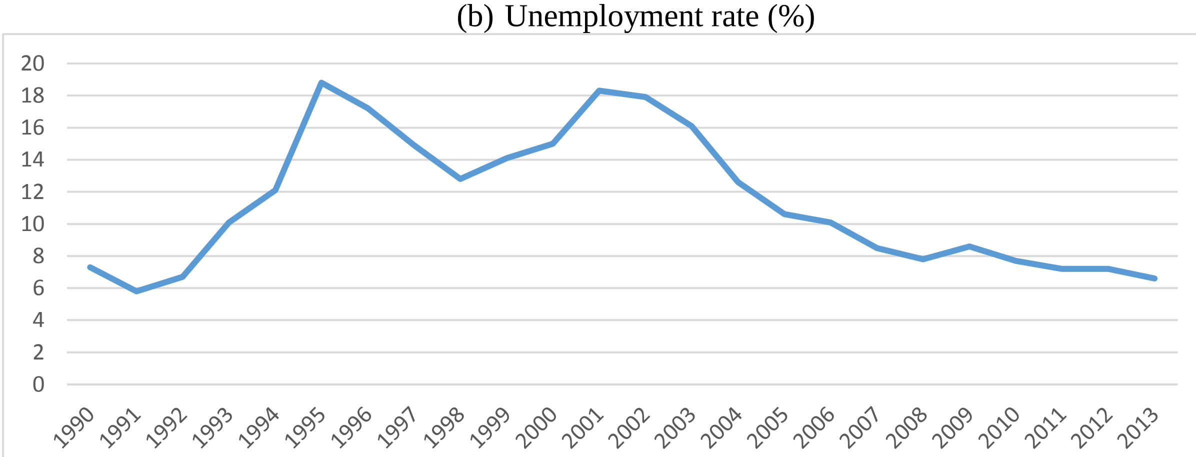
[58] Fanelli (2012), in his growth diagnostic of Argentina, refers to this phenomenon as a "*síndrome de apropiación débil*" (weak appropriation syndrome).

Figures 5(a) and (b): Unemployment and public opinion about state ownership

(a) Answer to the question: "Would you say it's better to have a country with more private enterprises or more state-owned enterprises?" (blue for private, orange for state)



(b) Unemployment rate (%)



Sources: IPSOS and WDI.

During the 2000s, the huge social cost of the convertibility crisis made it easy to cast the policies of the convertibility period in a highly negative light. Any policy reversal from the earlier period – even if it was not a complete "U-turn"—could be cast as avoiding (or undoing) past "mistakes." Privatized companies and the private pension funds were "easy" targets for seizing assets, with popular political support. The favorable external environment, along with debt relief, made for extraordinarily favorable conditions for economic growth. It is only since growth slowed

to near zero that even traditional allies of the last administration – for example, the central labor union—took to the streets in protest. With political pressures building, it was even more difficult to conduct subsidy reform, especially when the privatized enterprises have already been cast as remnants of past policy failures.

In terms of establishing economic policy credibility in the new administration, one constraint is the legacy of policy reversals. Table 3 provides a brief summary. In the introduction, one of the characteristics identified of credible policies is that the policy is consistent with a longer-term vision or strategic direction. The types of policy reversals described in table 3—when taken as a whole—cast doubt on whether there has been any strategic direction to the policies of the last twenty-five years. Regardless of whether each policy was appropriate or not, the history of reversals has a reputational impact on the political economy of policy formulation in Argentina.[59]

In policy circles, many viewed the reforms of the 1990s in Table 3 as irreversible, including the currency board arrangement. History has shown that this was not the case. There is a long literature on investment under uncertainty[60], where many investment decisions are irreversible, the economic context is uncertain, and there is an option value to waiting until information is revealed about the future. Credibility of the continuity of policies, or in other the words, the risk of policy reversal is another potential source of uncertainty. Economic models have shown that lack of full credibility on policies can imply an additional source of uncertainty that leads to greater economic volatility and lower investment.[61] There is some empirical evidence in the case of trade policy reversal.[62]

Table 3: History of policy reversals

1990s	2000s
Independent central bank (1991)	New Central Bank Charter (2012)
Currency Board (fixed exchange rate) (1991)	Managed float with official and parallel markets (post- 2001 crisis)
Fiscal Solvency Law (1999)	Central Bank Financing of Deficit institutionalized (2012)
Pension Reform (individual accounts/AFJPs) (1994)	Pension system "unification" (public sector) (2008)
Labor Reform (2000)	New Labor Reform (revokes the 2000 law) (2004)
Founding Member of WTO (1995)	Import restrictions ("G3" complaint filed at WTO) (2012)
Privatizations: e.g. Telephone, airline, road concessions (1990); Railway concessions (1991); Water and sanitation concession, electricity companies (Edenor, Edesur), gas company (1992); Oil company (YPF) (1993); Postal service (1997); Provincial banks and provincial enterprises (various)	Nationalizations: e.g., Airline (2008); Railway (2015); Water services in GBA (2006); Oil company (YPF-Repsol) (2012).
Price deregulation	New Supply Law (2014)

[59] Duncan (2014) finds that poorer "institutional quality" – e.g., the rule of law and government stability—is closely associated with pro- or a-cyclical monetary policy and high degrees of macro volatility in emerging markets.

[60] A classic reference in this literature is Dixit and Pindyck (1994).

[61] See Calvo (1988) where capital mobility interacts negatively with the credibility problem; Calvo and Mendoza (1994), Calvo and Drazen (1997), Hopenhayn and Muniagurria (1996) and van Wijnbergen (1992) for various models on policy reversals in trade reform,

[62] Ibarra (1995) found that the probability of trade policy reversal had a negative effect on investment in Mexico following its trade opening in the mid-1980s.

On the role of political institutions, Argentina has some characteristics that stand out with respect to other Latin American countries (IDB, 2006). For example, on an index of political party centralization, Argentina scores the lowest of any country in the region: suggesting that Presidential influence over his/her party is exercised through negotiation with regional factions or political factions within the party, or individual legislators.[63] Argentina ranks very low on the degree of political party nationalization, suggesting that regional territorial interests remain strong.[64] Argentina has an unusually low reelection rate for representatives in Congress, which also reinforces the strength of local party leaders who control party candidate lists.[65] Argentina also ranked at the lowest level in the region for the degree of judicial independence, implying the potential for political influence on judicial rulings.[66]

"Micro-political foundations"[67] of the credibility problem in Argentina

The "macro-dominance" described above is closely linked to what one might call the "micro-political foundations"—a more detailed approach to the institutional features described above. Spiller and Tomassi (2007) take a transactions approach to understanding policy making and apply it to the Argentine case. The fact that policies need to be both decided and enforced over time requires the ability to reach "intertemporal political agreements."[68] The policy reversal problem--described in historical detail above—can be viewed in this framework. "Macro-dominance" can also be viewed as a problem of short-sighted political actors responding to external macro events and taking distortionary micro-economic actions in response to those events. Without getting into all the details of their book, Spiller and Tommasi conclude that there are nine key features of the Argentine policy-making process:[69]

"1. Congress is not an important policy-making arena.

2. The executive has substantial leeway to take unilateral policy action.

3. Provincial political powers (especially provincial governors) are very important in national policy making.

4. There is a symbiotic interaction between national and provincial policy making that operates through political and fiscal channels.

5. Given the incentives of the executive of the day, of legislators, and of provincial governors, there is little investment in policy-making capacities in several spheres.

6. Fiscal federalism considerations are a factor in almost every policy issue, adding transaction difficulties and rigidities to policy making.

[63] IDB (2006), Figure 3.3., page 40.
[64] IDB (2006), Figure 3.4, page 41.
[65] IDB (2006), Figure 3.5, page 51.
[66] IDB (2006), Table 4.3
[67] Term coined by Spiller and Tommasi (2007).
[68] Ibid, page 3.
[69] Ibid, page 7.

7. The bureaucracy is not an effective corps to which to delegate the technical implementation of policy bargains.

8. The judiciary does not provide much intertemporal "glue" to political or policy agreements.

9. Nongovernmental actors in the policy process (such as business groups and unions), lacking a well-institutionalized environment for political exchange, usually follow strategies that attempt to maximize short-term benefits and to build in rigidities into future policies."

On the macro policy front, one can see clearly how these features translate into the historical experience. Given the historic inability to reach agreements in Congress – along with fiscal federalism tensions -- the only way to bring discipline to macro-policy was to tie the policy framework to the currency board. This rigidity proved flawed when the external economic environment changed, and there was no clear way to negotiate a credible new macro framework. The rigidity of federal revenue-sharing arrangements is another example, cited by Spiller and Tommasi, of locking in place privileges for jurisdictions receiving extraordinarily high transfers per capita. In brief, the authors note that, in the 1990s, "…many reform measures amounted to a front-loading of payoffs to many key actors, such as local business groups favored by privatization, key unions favored by reforms in the health and pension system, and pension funds that charged very high up-front commissions."[70]

Citizens' perceptions and engagement: Foundations for future credibility?

There is a rapidly growing, recent literature on transparency, government accountability and political engagement.[71] Both the theoretical and empirical literature has evolved. One strand focuses on transparency itself, defined as "…citizen access to publicly available information about the actions of those in government and the consequences of these actions."[72] Recent research has focused on the information content of what is disclosed to the public and also how the mass media delivers that content to the public.[73] Transparency of information can fall into a vacuum unless the public is politically engaged enough to use that information.[74] Political engagement can be defined as "…the participation of citizens in selecting and sanctioning the leaders who wield power

[70] Ibid, page 8.

[71] Guidance from Stuti Khemani on these issues is gratefully acknowledged. This brief section and footnotes draw on the World Bank Policy Research Report *Making Politics Work for Development: Harnessing Transparency and Citizen Engagement* (World Bank, 2016).

[72] World Bank (2016), page 5.

[73] Besley and Burgess (2002), Stromberg (2004), Snyder and Stromberg (2010) show that mass media enables political accountability through political engagement. Prat and Stromberg (2011) show how the coverage of issues, or the information content and framing of messages in media markets is a function of political institutions, which in turn shapes the impact of media on political accountability. Keefer and Khemani (2014 and 2012) show that the content of media programming matters in whether it impacts government accountability.

[74] Bobonis et al (2013) provide direct evidence that transparency's impact in reducing corruption is significant only in municipalities where there is effective political competition. On the negative side, Chong et al (forthcoming) show that NGO-provided information about corruption in municipal governments in Mexico led to voter discouragement and fall in vote shares of all political parties, not just the incumbent. Cruz, Keefer and Labonne (2015) et al show that greater information can even lead to increases in the use of vote buying as a political strategy.

in government, including by entering themselves as contenders for leadership."[75] Effective accountability occurs when transparency and political engagement are mobilized to select better quality leaders or to motivate existing leaders to follow policies that are in the public interest—i.e., have technical merit and address key development objectives.

The quality of political engagement also matters. Government failures may occur when there is "unhealthy" political engagement; that is, "…when leaders are selected and sanctioned on the basis of their provision of private benefits rather than public goods." The historical survey of Argentina in this paper established that, in the macroeconomic realm, the lack of central bank independence was combined with fiscal policies that often led to "buyouts" for political benefits. This was complemented at the microeconomic level by regulatory policies that were also influenced by organized special interests, either business, labor or populist movements.

The nature of political institutions also enters into how political engagement makes a difference in policy making. The institutional features of the Argentine policy-making process were discussed above. In addition, the relationship between political leaders and citizens has a role in reshaping the policy making process. In this regard, the informal beliefs and modes of behavior of citizens towards the public sector can evolve as policy actions are taken and access to information improved. Over time, the relationship can evolve from personalized paternalism and conflict to a more informed debate on what are the technically sound policies that are in the broader public interest. The transparency of information can play a critical role in supporting this process.

There is the possibility that the elections of late 2015 may have been the first step in establishing a greater degree of credibility in policy making via greater political accountability and "healthier" forms of citizen engagement. An emerging literature points to the scope for bottom-up (popular movements) or top-down (leadership) shifts that bring in a new approach to policy making.[76] It is not by any means guaranteed. Political institutions do not change easily. The persistent policy volatility and accompanying economic volatility of the last twenty-five years was not an accident. That said, a minimal degree of "normalcy" to policy making could have an important impact in terms of signaling the administration's commitment—where one can define "normalcy" in terms of publishing reliable macroeconomic data, assuring that government payments (including debt service) are reliable and timely, establishing a coherent monetary and exchange rate regime, and limiting reversals in policies at the microeconomic level. In addition, simply reverting to a renewed cycle of rapid policy reversals could reinforce the reputation that these cycles are to be expected in Argentina. For example, pragmatic reforms to state-owned enterprises or the national pension system that improve fiscal and financial sustainability might enhance a return to credibility more effectively than "re-privatizing" these entities.

[75] World Bank 2016, page 3.

[76] See, for example, Bidner and François (2013) on the emergence of political accountability. Also see Persson and Tabellini (2009) and Besley and Burgess (2002). See Açemoglu and Robinson (2001) for a model of more radical regime shifts from democratic to nondemocratic states, motivated by the degree of inequality and redistribution. Keefer and Vlaicu (2008) present a model of why some new democracies may stay in low credibility states whereby clientelism and patronage politics persist.

VI. Possible paths forward

Recall that in the introduction, three characteristics of policies were suggested that would support credibility: (i) the policy has internal logic and rationale and appears to have the right magnitude to achieve its goals; (ii) the policy is based on reliable data and trusted institutions; and (iii) the policy is consistent with a longer-term vision or strategic direction. The first criterion is really a pure technical viability issue: an informed public or opinion makers should be able to detect whether a policy makes sense. This criterion is not really addressed in the theoretical literature on the interaction between government policy, people's beliefs, and the credibility inherent in those beliefs.

The other two criterion are addressed in the literature. In one of the earlier papers on policy reform credibility, Rodrik (1989) asked the question why would the public doubt that government would continue with policy reforms, despite repeated assurances from the government. He then suggested three categories of answers, based on purely rational behavior. One is that the policy reform is inconsistent with other policy actions undertaken at the same time. This reminds one of criterion (iii) above that the policy should be consistent with a longer term vision or strategic direction. The second category is the time consistency problem discussed earlier in this paper. If there is a clear incentive for the government to deviate later, then it is rational for the public to expect the government to change its policy later. A solution to this problem is along the lines of the institutional aspect of criterion (ii) above: commitment mechanisms and reputation building can instill trust in the institutions setting policies and implementing them. Rodrik's third category is the problem of incomplete or asymmetric information. The public may not really know or understand the motivation of the government. Governments may then have to take even stronger reforms than technically necessary in order to "signal" their true intent.

Given the political transition in Argentina, the signaling of a new approach might require a package of policies that reinforce each other in terms of credibility. One of the paths forward might be to consider packages of reforms, each of which comply with the three criteria set out in the introduction to this paper.

Another key consideration in the path forward is the macroeconomic dominance, discussed above in the historical context, which probably persists today. It will be difficult to immediately unwind microeconomic problems created by export taxes and artificially low public utility tariffs unless a credible path for the fiscal accounts is established. It will also be difficult to convince investors that expropriation will not take place unless the government re-establishes access to normal forms of finance from the markets. Finally, a simple step to re-establish confidence would be to publish accurate and externally validated macroeconomic data, starting with inflation.

Since assuming office, the new administration has taken a number of actions. On the data front, the statistical agency (INDEC) resumed the publication of trade data, and the government took steps to restore the technical capacity of INDEC to produce reliable inflation estimates, as well as improve the national accounts. The government moved quickly to reach an agreement with holdout creditors, and the agreement was passed by Congress. The Central Bank has regained its focus on inflation and has been absorbing excess liquidity. In addition, monetization of fiscal

deficits has been reduced. The exchange rate was unified in December. The Government is taking a gradual approach to fiscal adjustment with deficit reduction targets spaced over time through 2019. In addition, the Government has suggested that normal relations with the IMF will be resumed in the near future, and some economic reports and documents associated with the 2013 financial sector assessment have been released to the public.

On the ***microeconomic*** policy front, the approach can be more gradual, and a number of measures like subsidy reform, would be supportive of the macro framework. One up-front signaling measure could be a change or revocation of the Supply Law. There are also microeconomic links to the macro policies listed above. For example, uncertainty over the true rate of inflation makes it difficult to negotiate labor or other business contracts over time. Trade restrictions affect the exchange rate and monetary policy listed above.

One mechanism is the creation of commissions or other semi-autonomous agencies that can be used to enhance the credibility of the future reform program. In these cases, the government is often delegating some authority for decision-making; however, a democratically elected government cannot transfer democratic “legitimacy” (Majone, 2005). As such, it would be important that any proposed commission establish forums for information sharing, transparency and public debate that offer opportunities for civic engagement to enhance accountability of these commissions. Rules would also need to be clearly established and publicly debated on when the government authority can overrule decisions made by these commissions.

In addition, rules and commissions can still be overturned, captured or abolished by the political system. Legitimacy, in a democratic system, requires acceptance by the general population, as articulated through political institutions. If those institutions are captured by elites or corporatist interests, then these distortions in the political system can undermine the rules-based approach. In addition, commissions do not replace the need for effective citizen engagement to produce policies that are neither too rigid, nor too unstable.

The immediate focus of government reforms has been more on the macroeconomic front – something that this paper advocates. That said, the government has reduced export taxes substantially on major crops and removed them completely from manufacturing goods. The import licensing has been streamlined, and existing license requests have been expedited. Utility subsidies have been reduced via significant price increases, but with the creation of a “social tariff” targeted to low income households.

The government has also taken a number of actions in the social policy realm. In some cases, they involve recognizing past inflation: adjusting the minimum wage and past pension payments, increasing the monthly amount received in unemployment insurance, raising the threshold for businesses to be eligible for the single unified business tax (*monotributo*), and raising the minimum threshold for paying income taxes. There are also proposals put forward to create a basic minimum pension for poor retirees, as well as VAT rebates for retirees and recipients of child subsidies.

The administration submitted a new access to information law, which was recently approved by the lower house of Congress. The recent literature suggests that “(t)ransparency is

most effective when it supports the generation of specific, reliable, and impartial evidence on the performance of leaders tasked with the delivery of public policies."[77] Public interest programming and the promotion of competition in media markets are important elements that go beyond the access to information law itself. This extends to the functioning of media markets at the local level as well. A key dimension is jurisdictional: information on the performance of public policies needs to be targeted to the jurisdictions in which citizens select leaders; that includes information about potential political contenders to avoid "incumbency bias."

The government has also announced plans to move forward with a general reform of the judicial branch, including the Magsitrate Council and the Organic Laws of the Attorney General and Judicial branch. In addition, there are proposals put forth for political reform, unifying the calendar of elections and paper voting.

A practical strategy for securing political support necessarily would enter into the design of the reform program, and so far, this seems to be the case. If a few of the above measures can release investment that has been waiting on the sidelines, then the boost to economic growth will make political support much easier to attain. Some measures above – like reforming the supply law and gradually removing export taxes on commodities – should help gain political support from powerful business groups. The removal of subsidies has been accompanied by other social policy reforms to avoid a popular backlash. Political legitimacy also depends upon the public's perception of the fairness of the overall approach to economic policy. Regional dimensions would also have to enter into the calculations as well, and negotiations between federal and provincial authorities have been initiated.

During the economic stress leading up to and immediately following the elections, the government used special decrees to enact numerous measures. This is a time-honored method for crisis periods, and it also perhaps recognizes the challenges in the policy making system, as described above. On the other hand, it represents a side-tracking of citizen engagement that would not bode well if deployed persistently. It should be noted that, in recent months, the administration has followed the established legislative process to enact other policies.

As a note of caution, despite the rapid reforms, consumer confidence has plummeted since the start of 2016. Only time will tell whether the recent transition will lead to a deeper reform of the policy making process, with greater citizen engagement based on transparency of information. Institutional reforms in these areas will be a necessary condition for ending the cycle of policy reversals and enhancing the longer term credibility of government policy.

This survey of the history and literature of Argentine economic policy-making, from a credibility perspective, might raise more questions than it answers. On the other hand, as noted by Guillermo Calvo, "…credibility is not helped by pretending that the problem does not exist, and much less by relying on advisors who ignore its key role."[78]

[77] World Bank (2016), page 18.
[78] Calvo (1989), page 231.

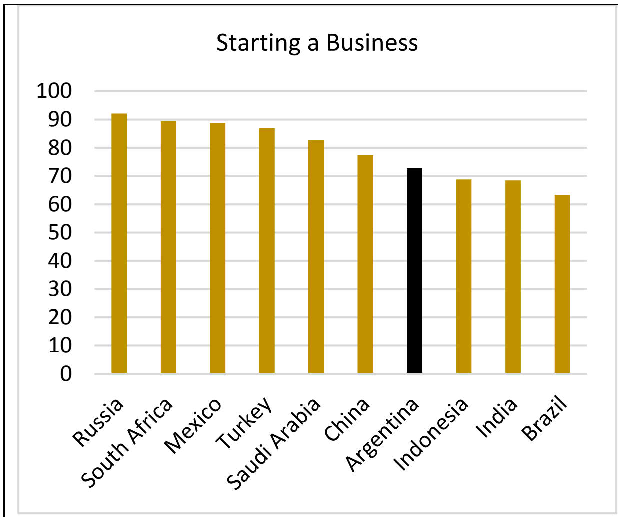
Annex 1:
Key Political, Economic Policy, and External Events – A Chronology of the Last 25 Years

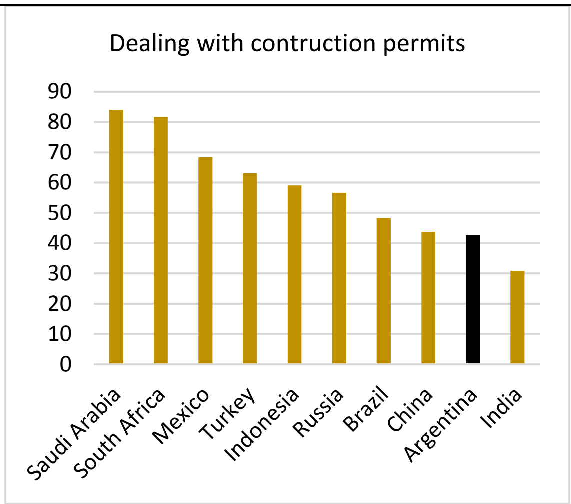
Year	Political Event	Economic Policy	External Event/Agreements
1989	Election of President Menem		
1990		-Telephone company privatization -Privatization (partial) of *Aerolíneas Argentinas* -Start of road concessions	
1991		-Convertibility Law (Currency Board) -New Central Bank Charter	-Mercosur (*Treaty of Asunción* signed) -IMF Program -Paris Club agreement
1991		Start of railway concessions	
1992		-Financial Administration Law -*Pacto Fiscal* I -Electricity company privatizations (Edenor/Edesur) -Privatization of *Gas del Estado* -Water and sanitation concession	
1993		-Privatization of YPF national oil company -*Pacto Fiscal* II - Pension Reform (creation of AFJPs, individual retirement accounts)	
1994	Constitutional Reform		-Mercosur common market enters into effect (end-December) - Mexican "Tequila" Crisis (December) -*Plano Real* launched in Brazil
1995	President Menem re-elected		-Argentina is one of the founding members of the WTO
1997		Postal service privatization	Asian Financial Crisis
1998			Russian Debt Crisis

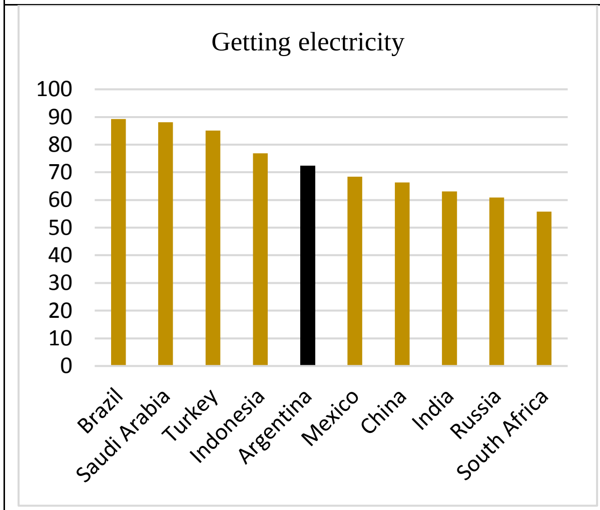
1999	President de la Rua elected	-Fiscal Solvency Law -*Compromiso Federal* 1	Brazilian recession and sharp devaluation of BRL.
2000	Vice-President "Chacho" Alvarez resigns (October) (effective end of "Alianza")	-Tax reform ("*impuestazo*") -Labor Reform (Ley 25.25)) -*Compromiso Federal* 2	"Blindaje" (Shield) – external support package led by IMF (November?)
2001	-Three different Economy Ministers in first half of year (Machinea, Lopez Murphy, Cavallo) -Removal of the Central Bank President (April) -Resignation of President de la Rua (December 20th) -3 interim Presidents during remaining days of December	-"Voluntary" debt exchange (March) -"Fiscal devaluation" (import taxes with export subsidies) -Zero Deficit Law (July) -"*Corralito*" freeze on deposit withdrawals (December) -External debt default (cessation of payments) (December)	
2002	Interim President Duhalde takes office January 1st.	-End of Currency Board -Devaluation -Measures to stabilize financial system -Asymmetric conversion of dollar assets/liabilities -Export taxes introduced	
2003	Election of President Nestor Kirchner; takes office in late May		
2004		-Fiscal responsibility law (provinces' debt service < 15% of current revenues net of transfers to municipalities) -Railway concession revoked, start of series of nationalizations of previously privatized enterprises -New Labor Law revokes the 2000 reform.	
2005		-Debt exchange with private external creditors. About 75 percent adherence.	-Debt exchange with private external creditors

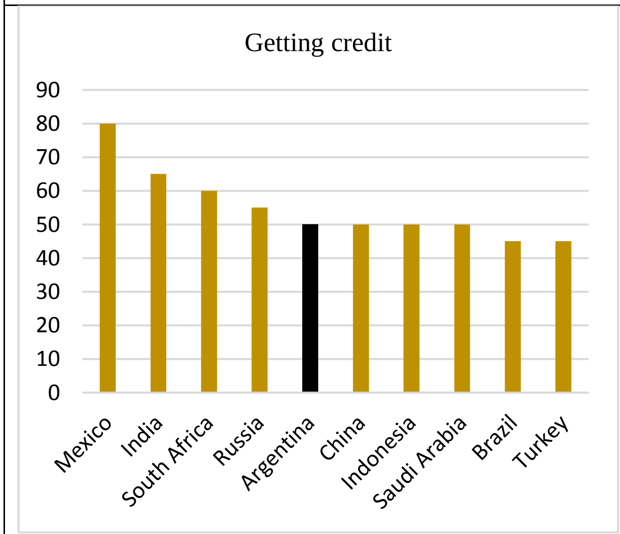
2006		-Nationalization of water services in greater Buenos Aires	
2007	Election of President Cristina Fernandez de Kirchner	-Government intervention in the statistical agency (INDEC) for inflation methodology (January)	
2008		-"Unification" of pension system with assets of private funds transferred to the state -Airline nationalized	Start of global financial crisis/"Great Recession"
2009			"Great Recession"
2010	Death of former President Nestor Kirchner	Second phase of debt exchange with creditors (about two-thirds of holdouts from 2005). Only 7 percent of debt now held by holdouts.	Non-oil commodity prices start falling
2011	Re-election of President Cristina Fernández de Kirchner		
2012		- Import restrictions -Reform of Central Bank Charter -Nationalization of the YPF oil company	US, Japan and EU file complaint with WTO against Argentina for import restrictions
2014		-New Supply Law -Agreement reached with Paris Club creditors - Default on restructured debt following court ruling in New York (July)	-WTO rules against Argentina -End of "RUFO" clause on exchanged debt (end-December)
2015	-Death of Alberto Nisman (AMIA investigator) -Elections in October result in victory for Macri	-Nationalization of railways -Exchange rate reunification in December	-Oil price collapse
2016		-Deal reached with holdout creditors -Reduction in export taxes -Public utility price increases	

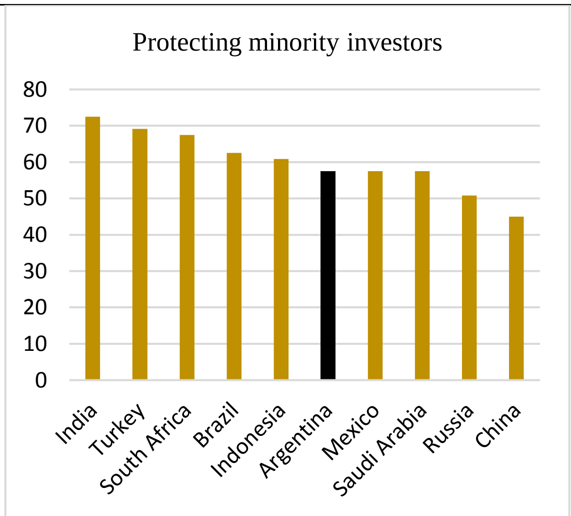
Annex 2:
Doing Business (2005) Indicators in Comparative Perspective, Distance to the Frontier

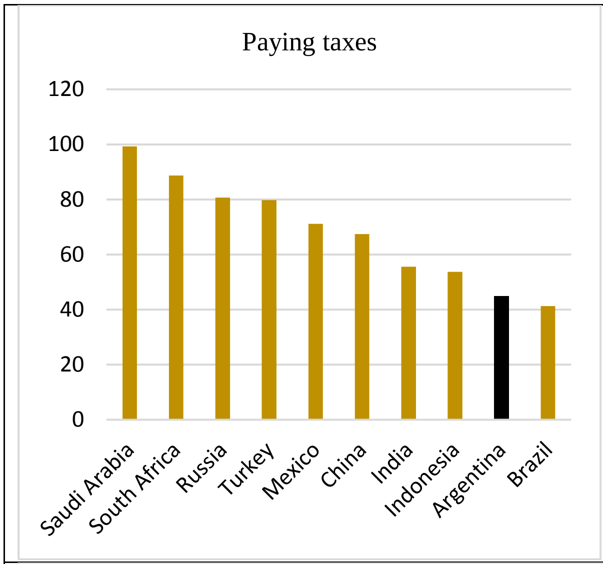











Paying taxes
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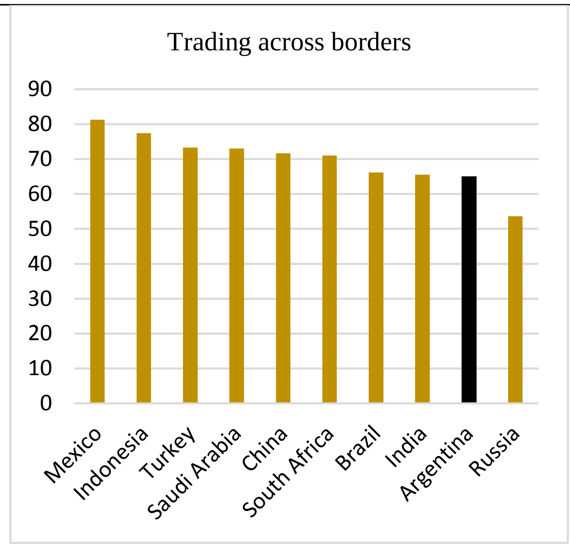
Trading across borders
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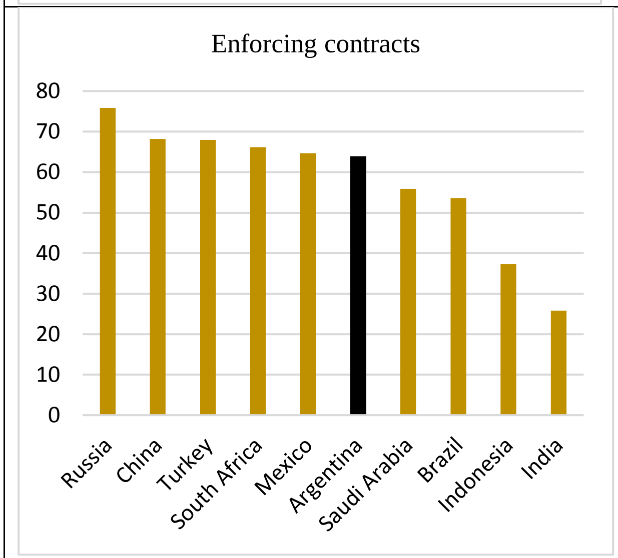
Enforcing contracts
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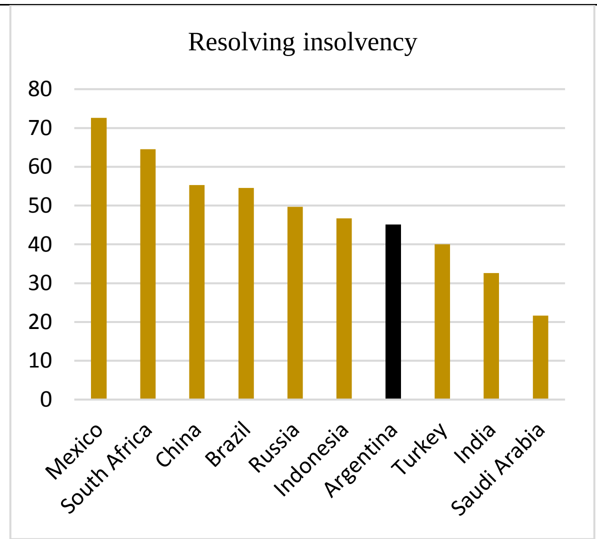
Resolving insolvency
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Mexico
South Africa
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Brazil
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Indonesia
Argentina
Turkey
India
Saudi Arabia

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