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Breaking Bad (the Rules): Argentina Defaults, Inflates (and Grows), 1997–2015

On January 13, 2015, Jacinta Mazzoni (HBS '07), a recently hired principal at a leading international consulting firm in Buenos Aires, stared at the screen in disbelief. She wanted to convert her year-end bonus to U.S. dollars, but it appeared to be impossible through formal channels. Like many Argentines, Mazzoni liked to save in U.S. dollars. But in late October 2011, after losing 1 billion in dollar reserves in one month (2%), the Argentine government had begun imposing a series of currency controls, limiting the ability to buy foreign currency. Argentina's tax collection agency, AFIP,[1] had been granted the power to approve or reject all requests to buy dollars with pesos. By June 2012, AFIP had removed "saving" as a legitimate explanation. Although Mazzoni tried hard to follow the rules, it appeared she would have to look to "informal" options if she wanted any dollars at all. But when she looked for the latest black-market exchange rates, she couldn't believe her eyes: while the official exchange rate was almost 8.6 pesos to the dollar, the black market asked for 13.7 pesos to the dollar—a nearly 60% difference in values (see **Exhibit 5a**). A quick calculation reinforced her frustration: the year's salary was $32,500, instead of the $50,000 she had anticipated.

These were not the first currency restrictions that Argentina had imposed on its citizens. In 2001, the government had imposed a *corralito* (little fence) that limited deposit withdrawals from banks. Such restrictions had been viewed as an intolerable infringement on property rights, prompting violent attacks on banks, riots, and, eventually, the downfall of the government. This time, in contrast, the political climate was relatively stable. Although there was some capital flight, President Cristina Kirchner had been reelected by a landslide vote (54.1%) a week before the restrictions were announced,[2] and the currency controls had, at least initially, calmed the capital flight (see **Exhibit 5b**).

The Unraveling of a Fixed-Exchange-Rate System[3]

The 1980s were a turbulent decade. The Latin American debt crisis meant that most governments in the region experienced deep fiscal troubles amid massive capital flight. Inflation ensued, but stabilizations were delayed, often out of a fear that they would imply a deep recession. Argentina went through two hyperinflations before finally finding some stability by pegging the peso to the U.S. dollar in March 1991. The Convertibility Plan, the brainchild of Harvard-trained economic minister Domingo Cavallo, employed a currency board, requiring the Central Bank to hold as many

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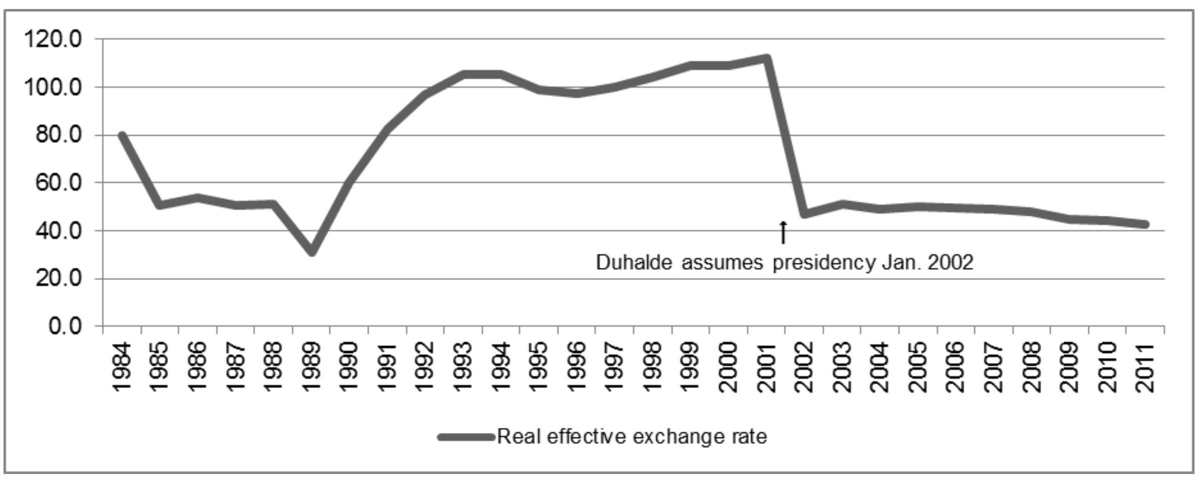
foreign exchange reserves as there was cash in circulation (plus the commercial banks' reserves parked at the Central Bank). The Central Bank was thus stripped of its credit function: it could not intervene in the case of a slowdown by easing the money supply. In addition, convertibility eliminated indexation of prices and wages and created a fully independent Central Bank under which the term of the bank's president would be longer than the government's electoral cycle. It also made the U.S. dollar legal tender, effectively creating competition between currencies. The plan was feasible because the economy was already "dollarized," with the U.S. dollar as the preferred store of value and unit of account. In addition, hyperinflation in the late 1980s had reduced the monetary base to manageable levels, with international reserves sufficient to support the peg at the chosen rate.

Without the ability to print money to cover a deficit, the Argentine government was forced to curb spending. The result was a dramatic reduction in inflation. In contrast to what most economists predicted (using data from countries with a history of low inflation), this did not bring a recession. Investment poured in and the economy actually grew over 9% per year in 1991–1992. The newfound stability helped then President Menem enact far-reaching free-market reforms—including the elimination of wage and price controls, trade liberalization, pension reform, and the privatization of state-owned enterprises. In fact, about 90% of all state companies were privatized between 1991 and 1994.

At the same time, observers worried that the peso was becoming overvalued. (See **Figure A**.) Following the fixing of the exchange rate in early 1991, it took Argentina's inflation rates two years to settle down to international levels. While Cavallo insisted that market reforms would induce large productivity gains, economists questioned whether these would be large enough to counter such large price increases. In spite of these concerns, export performance improved dramatically.

Figure A Real Effective Exchange Rate (REER) for the Argentine Peso (1997 = 100)



Source: The Economist (EIU) database. The REER is a trade-weighted basket of currencies (U.S. dollar, euro, yen, etc.) converted to an index (1997 = 100) and adjusted for relative price movements.

As Menem campaigned for his reelection, the first of a series of external shocks that would test the Convertibility Plan hit Argentina. On December 1994, the Mexican Central Bank ran out of dollars and was forced to float the exchange rate. The Tequila crisis caused a massive reversion of capital flows in Argentina and a sharp rise in interest rates. As depositors flew, and without access to

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emergency funds from the Central Bank, commercial banks struggled on the brink of collapse. An emergency loan from the International Monetary Fund (IMF), helped put an end to the run.

Following Menem's reelection in May, a set of banking reforms was announced. These included heightened oversight by the Central Bank and some of the highest reserve requirements in the world. There were also several bank mergers and foreign banks that took over 9 of the 10 biggest banks. The late 1990s brought three more external shocks—the Asian Crisis of 1997, the Russian Default of 1998, and Brazil's currency devaluation the next year. By 1999, Argentina was well into a recession, and Menem faced mounting criticism, including accusations of corruption.

In the presidential election of October 1999, the Peronist Party's candidate, Eduardo Duhalde—who, paradoxically, wanted to get rid of the Convertibility Plan—was defeated by a coalition led by the Radical Party's candidate, Fernando De la Rúa, with Carlos "Chacho" Alvarez, leader of a splinter group of Peronists, as his running mate. Running as *La Alianza*, they vowed to end Menem-era corruption and, perhaps more crucially, maintain convertibility and Menem's free-market reforms. Upon taking office, De la Rúa's economic team announced that the fiscal situation was worse than anticipated, justifying a tax increase.[a] Known as the *Impuestazo* ("big tax"), the unpopular tax hike was followed by weakened consumption indicators and a deepening recession. Four months later, on May 29, 2000, the government announced $1 billion in spending cuts in another effort to shore up the country's fiscal position. The cuts were met with widespread protests.

Soon a corruption scandal grabbed the headlines: it was alleged that senators were paid bribes in exchange for supporting a government initiative to increase flexibility in the labor market. Although initially ambivalent, Vice President Alvarez took up the case and demanded an explanation from his own government. In a startling move, he resigned in October 2000, alleging a lack of commitment to fight corruption on the part of the president. The *Alianza* coalition fractured, and only the support of the Peronist Party allowed key legislation to be passed in Congress.

Near the end of 2000, there was some good news: De la Rúa's economic minister managed to successfully negotiate a US$40 billion loan package (known as the "armor," or *blindaje)* with international and domestic financial institutions. At first, the markets responded positively. But in early 2001, as consumer confidence and tax revenues failed to pick up (see **Exhibit 9**), it became clear the government was not hitting the fiscal targets. In February 2001, Argentina swapped US$4 billion in bonds that were due to mature soon for longer-term bonds.

In March 2001, depositors withdrew $5.5 billion from Argentina's banking system—the most severe bank run in Argentina's history**.** The money supply shrank accordingly. Most capital flight occurred in domestic banks, particularly public banks, as these had been lending to the provincial governments.[4] As the run spread, observers wondered if foreign banks would provide assistance to their local subsidiaries. The provinces continued issuing "quasi money" to cover their bills.

Despite criticism from his own cabinet, De la Rúa appointed Domingo Cavallo, architect of the Convertibility Plan, as economic minister. Aware of his predecessors' failures to reduce spending, Cavallo focused instead on promoting economic growth through a law to promote competitiveness. He also introduced a small tax on all checks. It was described as distortive by several economists but was extremely well received, given its effectiveness in quickly raising a significant amount of

[a] Some argued that the 1999 budget deficit was not particularly large (see Ricardo Hausmann and Andres Velasco, "Hard Money's Soft Underbelly: Understanding the Argentine Crisis," Brookings Trade Forum, 2002). An upper bound estimate is 3.2% of GDP—more than triple the deficits of just 1% seen in 1997 and 1998. Part of the shortfall was driven by deficits at the provincial level. Several provinces began issuing provincial bonds that acted as new currencies.

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revenue. But with the economy still not growing, markets remained skeptical and difficulties financing the relatively small public deficit and the maturing debt remained. As confidence declined, rating agencies began downgrading Argentina. Overindebted business groups also suffered. It was reported that *Clarín,* the largest newspaper, had $400 million in debts in its social security fund.[5]

Four months later, Cavallo masterminded the "megaswap" (*Megacanje*), which extended the maturities of US$30 billion in debt but at a higher rate of interest (around 15% per year). While investors initially welcomed the program, the government was increasingly seen as weak, and Cavallo (and members of his economic team) were accused of taking bribes in the *Megacanje*. No longer able to finance spending, the government introduced a "zero-deficit" policy in July 2001. To this end, state pensions were reduced and salaries slashed by up to 13%. The government was then able to negotiate a US$8 billion increase in Argentina's standby loan agreement with the IMF.

In November, facing heavy capital and interest payments, Argentina attempted to execute another debt swap (see **Exhibit 9** for debt interest payments of 3.8% of GDP in 2001). In contrast to the *Megacanje,* the swap was not well received. Instead, capital flight escalated, and country risk climbed to 1,700 basis points (see **Exhibit 11** for bond spread data). After hitting a high of US$35 billion in January 2001, international reserves at the Central Bank by the end of the year stood at US$15.2 billion, a dramatic reversal of fortune (see **Exhibit 6**).

Problems soon escalated into a full-blown crisis. On December 1, 2001, a set of capital controls known as the *corralito* were instituted in order to stem the outflow of bank deposits. The *corralito* limited monthly withdrawals of cash from checking and savings accounts to US$1,000,[6] but did not restrict the use of credit cards and bank transfers within Argentina. It also limited foreign money transactions to operations related to exports and imports. On December 5, 2001, the IMF suspended disbursement of funds, alleging the country had failed to achieve the (relatively small) promised austerity measures. On December 17, the government presented a plan with large spending cuts. The public reacted with rage, marching to the presidential headquarters. Looting and violence, particularly against banks, plagued the protest-filled streets. At least 22 people died amid the furor.

De la Rúa resigned on December 21, 2001, with the crisis in full force. This triggered a messy succession process that would see five presidents in the span of two weeks.[7] Interim president Adolfo Rodríguez Saá, in his first week in office, declared the country's intention to default on its foreign public debt. He also attempted to preserve the fixed-exchange rate, while at the same time helping the banks, by issuing a new (nonconvertible) currency: the *Argentino*. But only a few days later, when the Peronist Party withdrew its support, Congress elected Eduardo Duhalde president. Having lost the 1999 presidential race (to De la Rúa), Duhalde had remained one of the country's most powerful politicians as governor of the Buenos Aires province.

This Is the End . . . : Duhalde and the Breakdown of Convertibility

On January 3, 2002, one day after Duhalde's appointment as president, Argentina formally defaulted when it missed a payment of US$28 million on a lira-denominated bond. Duhalde then enacted a series of emergency measures.[8] On January 6, he devalued the peso-dollar exchange rate for trade by 40% (to 1.4 pesos per dollar), and allowed a dual exchange rate to float for other transactions. The exchange rate exploded: the price of the dollar reached 3.76 pesos on October 8, 2002, before settling to 3.39 by the end of the year.[9] Following the devaluation of the peso, the price of tradables, like grains and food, nearly doubled,[10] causing poverty to rise dramatically. In 2002, official statistics reported 54% of the nation living below the poverty line.[11] The media reported that at least 10 children died of hunger in the northern province of Tucumán in a matter of weeks, with about 60

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per month seeking hospital care for severe malnutrition around the country.[12] By some measures, consumption fell by almost a quarter of its pre-crisis value, while investment was cut in half (see **Exhibit 8**).

Attempts were made to control prices. The first target was the utilities: the country's telephone, water, and energy companies had been given contracts (at the time of privatization) promising to tie their rates to the value of the dollar. Given that such dollarization of contracts had made them too onerous in the new circumstances, Duhalde abrogated them. He converted them into pesos at a one-to-one exchange rate, making future changes subject to government approval. He also froze the prices of fuel and medicine.[13]

Debtors were also in trouble. The depreciated exchange rate meant that most debts in the economy, which were tied to the dollar, were exploding in value. Duhalde ordered that all dollar-denominated loans to private parties worth more than US$100,000 be converted into pesos at a one-to-one exchange rate.[14]

While this provided some relief to debtors, banks were now in a bind. Depositors who had hoped to preserve their savings by keeping "dollar" accounts insisted on recovering their deposits adjusted by the new exchange rate. This would have allowed them to recover as many dollars as they had originally deposited. Banks, however, were unable to comply, as the loans they had made with those deposits had been "pesified" by the Duhalde administration. In the end, the government settled on an intermediate response: the public's bank deposits were converted at a rate of 1.4 pesos per dollar, while bank loans were converted at a one-to-one peso-to-dollar rate. Those who refused were given peso-denominated bonds linked to inflation. With the price of the dollar closer to 4 pesos, depositors were furious and started a series of legal battles that would reach all the way to the Supreme Court.

With banks on the brink of collapse after the "asymmetric 'pesification,'" a Spanish banker protested: "In effect, we are being asked to bear the brunt of a devaluation." The government then compensated banks with 10-year federal bonds (indexed to Argentine inflation) at favorable terms. The government initially issued US$14.2 billion in bonds as part of the compensation for banks and their depositors.[15] As a result, bank holdings of government bonds ballooned from 17% of all bank assets in 2000 to almost 50% by the end of 2002.[16]

In February 2002, Congress passed a bankruptcy bill (against the advice of the IMF) that gave increased time for reorganization, made it more difficult for secured creditors to seize collateral, and mandated a 180-day suspension on foreclosures.[17] Duhalde then pushed through an 80-fold increase in export taxes (from essentially zero to 10% of all federal tax revenues) and instituted a tax on financial transactions.[18] Members of the business community resisted. Repsol YPF, the country's largest oil company, described the new tax on oil exports as "plunder." Nevertheless, overall tax revenues continued to fall (see **Exhibit 9**). During 2002, the economy contracted by nearly 11%, unemployment reached 21.5%, and over half of Argentines lived in poverty.[19]

By early 2003, some sense of normalcy was regained. The prices of the commodities Argentina exported had begun to pick up, and the devalued and relatively stable exchange rate favored exports. Duhalde enacted a variety of poverty-relief efforts, the most important of which was a program for unemployed heads of households (Plan *Jefas y Jefes de Familia Desocupados*). By the end of Duhalde's term in May 2003, the number receiving the AR$150 (Argentine pesos) per month (then equivalent to about US$54) reached its highest point: over 2 million families. The plan cost the government almost 1% of GDP, but there were signs that it was working to save families from poverty.[20] After reaching almost 45% during the 1990s, the share of total GDP going to "labor" stood at 34% in 2003.[21] (The Peronist "ideal" was that the labor share of GDP would be 50%.)

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In the end, Duhalde called for elections in April and chose not to run, giving his imprimatur to Néstor Kirchner, governor of the oil-rich Patagonian province of Santa Cruz. Menem, despite having served six months under house arrest in 2001 in connection with charges of illegal arms dealings, decided to run.[22] On April 27, 2003, Menem won with 24% of the votes, followed closely by Kirchner, with 22%. With no candidate in a majority, a runoff was scheduled between Menem and Kirchner. Menem, however, dropped out once it became clear that he would lose.

"He is our Rambo": the Kirchner Years

Following his election, Kirchner announced he would keep Duhalde's economic team. Facing poverty rates in excess of 50% and high, albeit decreasing, unemployment levels, Kirchner promised in his inaugural address that his government would not make debt repayments "at the price of the hunger and exclusion of Argentines."[23] In July 2003, Kirchner announced a 50% hike in the minimum wage, to be financed partly by the private sector and partly by the government. The move was questioned by economists and the press. The main criticism seems to have been that it would push more workers into the informal sector[24] and irritate "the hundreds of thousands of investors holding defaulted Argentine bonds."[25] In the end, the wage hike did not discourage formal employment (in fact, unemployment rates fell) and was resoundingly popular.

Building on popular sentiment, Kirchner blamed the 1999 IMF-backed austerity plan and 10 years of "very bad advice" for pushing the country into four years of recession. He told IMF Managing Director Horst Kohler outright: "You are greatly responsible for what happened in Argentina."[26] The two sides argued for months, with Kirchner refusing to agree to terms that he thought would weaken his country's incipient recovery. Finally, on September 9, 2003, Argentina, with seemingly little to lose, defaulted on a $2.9 billion payment due to the IMF, representing the largest nonpayment of a loan in the fund's history. The next day, the IMF was forced to concede to a three-year deal at terms favorable to Argentina.

Kirchner claimed to have shared the left-leaning ideals of the generation that fought the military during the 1970s (although evidence of any direct involvement by him or his wife was hard to come by, he did appoint several former guerrillas to the government). Within his first two months as president, he pushed for reopening the legal cases against the military leaders convicted of human rights violations during the Dirty War, who had been brought to trial during the Alfonsín presidency (1983–1989) and had been subsequently pardoned by Menem. "Two months into his presidency, Nestor Kirchner has become known in Argentina for a brand of populist politics and a willingness to challenge the rich and powerful," wrote the *Washington Post* in July 2003.[27] There was also praise for the institutional reforms he spearheaded, including the removal of several Supreme Court judges on the grounds that they were of low quality. That month, it was reported that Kirchner's approval rating stood at a resounding 80%. "He is our Rambo," one political consultant was quoted as saying.[28]

The recovery of the first half of 2003 turned into a boom. Economic analysts expected growth of only 2% in 2003; instead, the economy expanded 8.8%. It was the first year of GDP growth after almost five years of contractions (see **Exhibits 3a** and **3b**). Critics emphasized that the surge in commodity prices deserved part of the credit; Argentina was one of the world's top producers of corn, soybeans, and wheat (see **Exhibits 7, 14a,** and **14b**). But the impressive restoration of public confidence also seemed to play a big role.

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Renegotiation of the Debt

Emboldened by his success with the IMF, Kirchner declared to cheering crowds that private bondholders "could not be paid back in full while half of his country's people live in abject poverty."[29] He then pursued the largest sovereign debt renegotiation the world had ever seen, at almost US$100 billion (see **Table A** for a timeline). On September 22, 2003, in a meeting with the country's private bondholders in Dubai, Kirchner's delegates communicated his hard-line offer: a 75% "haircut" with no recognition of past-due interest. His view was that the burden of Argentina's foreign debt, largely denominated in dollars, had exploded in terms of Argentine pesos since the devaluation (see the increase in debt in **Exhibits 12a, 12b,** and **12c**), and an econometric model showed that 25% was the maximum debt that the country could afford to pay. He argued that the offer was consistent with their target of a primary budget surplus of 3% of GDP.[30]

With the implicit support of the IMF, creditors formed the Global Committee of Argentina Bondholders (GCAB) in Rome in January 2004. They demanded a "haircut" of no more than 40% on the face value of the bonds and full recognition of past-due interest. In a surprising development, Argentina held to its position of a 75% haircut. The only change was that it introduced a "kicker" stating that 10% of all GDP growth above 3% would be split 50-50 between increased interest payments and the amortization of outstanding debt.

A menu of options was offered to the creditors. The first was "Par bonds": new dollar-denominated 35-year bonds valued at par. The coupon would be 1.33% for the first 5 years, 2.5% for the next 10, 3.75% for the 10 years after that, and 5.25% for the remainder. There was to be a 25-year grace period on amortization payments. A second option was "Discount bonds": new dollar-denominated 30-year bonds with a 66.3% reduction in face value. The bonds would pay a coupon of 8.28%, but in the first 10 years, less than 6% was to be paid in cash, the remainder being capitalized. Afterward, the full coupon would be paid in cash. There was to be a 20-year grace period on amortization payments. The final option was "Quasi-par bonds": new peso-denominated 42-year bonds with a coupon of 3.31% plus domestic inflation and a 33-year grace period on amortization.[31]

The government convinced the country's five largest pension funds and the largest banks to subscribe to the offer. After Congress passed a law sponsored by Kirchner in February 2005 repudiating the bonds that were held out of the deal and prohibiting negotiations, bondholders representing 76% of the debt accepted the offer, leaving holdouts with debt bearing a face value of US$18 billion, but with an uncertain real value.[b] After a renewed swap offer in 2010, bondholders representing another 17% of the debt joined in, leaving just 7% in the "holdout" camp.

The remaining holdouts took Argentina to various courts to try to force repayment of the US$1.4 billion owed for more than a decade. While they won a series of rulings, Argentina still refused to pay. In October 2012, an Argentine navy training vessel, *ARA Libertad*, was seized in Ghana with a court order. (It was freed a couple of months later when the International Tribunal for the Law of the Sea ruled in Argentina's favor.) That same month, a U.S. appeals court upheld a lower-court ruling that Argentina must be barred from making payments on its restructured bonds unless it also paid back defaulted bondholders. The ruling unleashed a debate regarding the ability of sovereign countries in difficulty to reorganize their debt under New York jurisdiction. The order was suspended until the U.S. Second District Court of Appeals could deliberate on the matter, expected

[b] Seven years later, a 2012 Morgan Stanley report estimated that the value of the securities issued in the 2005s debt restructuring surged 90%. Meanwhile, the holdouts had remained held up in court, receiving nothing for their rejection of the offer. "Vulture funds" that bet that the government would eventually give in appeared to have bet wrong at that time.

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by the end of the summer of 2013. In August 2013, the New York Court of Appeals ratified the sentence in favor of the bondholders. Argentina then appealed to the U.S. Supreme Court. On October 7, 2013, the U.S. Supreme Court communicated that it was not going to review the case until all the information was made available to it by the beginning of 2014. [32] According to the terms of the restructured bonds, any concessions made on payments to the holdouts before December 2014 had to be transferred to the restructured bondholders.

Export Taxes, Spending, and Inflation

In 2004, Argentina continued to grow, and fiscal revenues continued to improve (see **Exhibits 3a, 3b,** and **9**). The primary budget surplus increased from 2.3% of GDP in 2003 to 3.9% in 2004, despite an increase in government spending. Crucially, the Kirchner administration had raised export taxes, which accounted for 42% of the 2001–2004 increase in federal revenue. Exports of crude oil were taxed at 25%, grain and soy products at 20%, milk products at 15%, cheese at 10%, and other products at 5%.[33] Export taxes were intended to serve two purposes. First, they would allow the government to take advantage of the windfalls generated by high export prices. Second, they would help contain inflation by lowering the net price of exports, making goods more accessible to domestic buyers. It was argued that Argentina, unlike many other nations, consumed the same products that it exported, so that rising international commodity prices, in the absence of taxation, fed right back into domestic inflation.[34] The second-largest contributor to the budget surpluses was the corporate income tax, which generated 25% of the increase in federal revenues.[35]

In 2005, Argentina's inflation accelerated. By the end of December, it had reached 12% (annualized).[36] According to private economists, the Argentine "output gap" had almost entirely disappeared, and the government would have been well advised to start slowing down the economy before inflation got out of hand.[37] Instead, in October 2005, the government announced that it would tighten price controls and increase subsidies to some of the firms that lost money under the scheme (for example, those in the transport sector). Firms that did not comply were pressured by the tax authority and in the media. Accused of endorsing too lax a monetary policy, the president of the Central Bank claimed that annual nominal growth in the money supply was only 5% in 2005, a contraction of 1.5% in real terms.[38]

During 2005, there were other conflicts with business, particularly with utility companies that had regulated prices. One of them involved the privatized water company, Aguas Argentinas (then owned by a consortium led by the French firm Suez). In January, the president denounced them in a speech, stating, "I find it hard to believe how spoiled these companies have become, that they sit and negotiate, asking for 60% increases in [the price of] water. 'No way, Jose' will we allow them to raise prices![c] First, let them provide water to the people." To foreign investors, he added: "Come to work, to invest, and to generate jobs, don't just come seeking profits." In the coming months, negotiations appeared fruitful, and an agreement involving a series of staggered rate increases seemed likely. But, by October, there was still no agreement. Néstor Kirchner then announced his decision to cancel the concession contract (thus renationalizing the utility), declaring: "There are companies like Aguas Argentinas that should acknowledge that what they did to us is shameful, because they have taken five billion dollars and they did not even build two pipes."[39] The shareholders of Aguas Argentinas commenced arbitration before the World Bank's International Centre for Settlement of Investment Disputes (ICSID). Economists were critical of government policy, arguing it would hurt investment. An informal system of government transfers in lieu of allowing rate adjustments was developed, which led to few (visible) conflicts with other utilities.

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[c] Originally: *Minga que les vamos a aumentar (las tarifas)!*

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The years 2006 and 2007 continued to be prosperous for Argentina, with investment booming (see **Exhibit 8**). In 2006, the new Supreme Court (with the more prestigious Kirchner appointees) finally ruled that the 2002 "pesification" of deposits was legal. Inflation, however, remained Kirchner's main concern (see **Exhibit 4**). On January 29, 2007, the chief statistician of the bureau of statistics (INDEC) was replaced by a government appointee. The media reported that the move was caused by her intent to publish an increase in the consumer price index (CPI) of 1.5% for January, a figure with which the government was not pleased.[40] The official 2007 CPI published by the INDEC was 8.5%, but private analysts estimated it to be three times as high. When they were fined (on "conspiracy" charges), opposition senators started publishing an average of the monthly inflation estimates of five different private analysts. Eventually, in February 2012, the *Economist* removed the official figures from its inflation indicators page, explaining: "We are tired of being an unwilling party to what appears to be a deliberate attempt to deceive voters and swindle investors."[41] It was estimated that the strategy saved the government over US$6 billion during a five-year period (for example, in payouts for inflation-indexed government bonds).[42]

During the last week of his four-year term as president, Néstor Kirchner approved a cable TV merger that gave the largest media group in the country, the Grupo Clarín, an unprecedented—some charged near-monopoly—reach into Argentine homes: 80% of those in Buenos Aires and 50% nationwide. This marked a period of good relations with the media: indeed, during Kirchner's term, average transfers to the four main newspapers in the form of "government advertising" reached eight times the average of the Menem, De la Rúa, and Duhalde presidencies. Interestingly, these cash transfers coincided with the "shrinking" of negative coverage (such as news regarding government corruption) on the front page of these newspapers[43] (see **Exhibit 17**).

Cristina Kirchner: Wife and President

On October 28, 2007, Senator Cristina Fernández de Kirchner (Néstor Kirchner's wife) was elected president of Argentina with 46.3% of the vote, followed by 23% for Elisa Carrió, who ran on an anticorruption platform.[44] Néstor Kirchner's decision not to run for the presidency himself was viewed by many as a move to "take turns" with his wife, circumventing the maximum two-consecutive-term limit established by the Constitution.[45]

The Kirchners continued to emphasize fiscal surplus (see **Exhibit 9**). Before the end of his term, Néstor Kirchner had sanctioned a new increase in the withholding tax on exports. As of November 8, 2007, export taxes had been increased from 27.5% to 35% for soy, from 20% to 28% for wheat, and from 20% to 25% for corn.[46] On March 11, 2008, the government announced an attempt to make the scheme more "rational." Although the (in)famous "Resolution 125" made export taxes on agricultural exports variable, current prices implied there was an immediate increase on soybean and sunflower export taxes.[47] The matter unleashed a national debate, with popular demonstrations nationwide. Even in the cities, widespread opposition was visible as citizens took to the streets, banging pots and pans.[48] After four months of turmoil, the president sent Resolution 125 to Congress. In the Senate, the final vote was exactly tied after a tense 17 hours of debate. In the early hours of July 18, and with citizens glued to their TVs and radios, Resolution 125 was repealed when the vice president uttered, "My vote is not positive," before casting the deciding vote against his own government.

Cristina Kirchner's approval rating dropped to 20%. Members of the government were furious with the vice president and with the media, which they accused of creating a moment of political defeat for the president. *Clarín* was seen as the main instigator. During the following year, the Kirchners accused the newspaper of publishing implicit Mafia-style threats and blamed it for their

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low standing in the polls. On October 10, 2009, the Argentine Congress promulgated the Media Law with a 44–24 vote in the Senate. It defined limits on the number of broadcast licenses that a company could own. Members of the opposition protested, denouncing it as an attempt to award licenses to political allies. Those in favor, including human right groups, maintained that this law would reverse the military-era broadcasting rules that gave excessive power over the media to a few big corporations. The Grupo Clarín was quick to complain, as it would have to divest from approximately 300 licenses to a maximum of 24. Eventually, following a long dispute, the Supreme Court ruled in favor of the government in 2013.

Nationalization of pension funds In the midst of the international financial crisis, on October 28, 2008, Cristina Kirchner's government announced that it would nationalize the private pension fund system that had been created by Menem back in 1993. Néstor Kirchner had tried to entice private pension contributors to switch to the public system back in April 2007, but over 9 million people had chosen to remain in the private system (even when most of its "investments" were government bonds). The global slowdown in economic activity was expected to prolong the drop in commodity prices and reduce Argentina's fiscal revenues by as much as US$6 billion in 2009. "By taking over the pension funds the government can continue to spend on programs that help it retain political support, which Mrs. Kirchner lacks after a debilitating four-month strike by farmers over export taxes," wrote the *New York Times* that month.[49]

The opposition Radical Party, which had opposed the creation of a private pension fund system at its inception, supported Cristina Kirchner's move to abolish it. Part of the funds was used to buy government debt, but a large proportion was used to pay social security benefits as well as the universal child subsidy (AUH, for its Spanish name, *Asignación Universal por Hijo).* The new program consisted of a monthly allowance of AR$180 per child under 18 years old (roughly equivalent to US$47 at the time), payable to the unemployed (or informally employed) parents or guardians. Eighty percent of the benefit was paid monthly, and 20% was accrued until March of the following year and was payable upon presentation of school certificates and health checkups. The rest of the funds were used to cover government debts.

It was estimated that the AUH reached close to 2 million homes and 3.7 million children, encouraging them to stay in school.[50] The AUH plan cost the government 0.7% of GDP[51] and represented 16% of total subsidies doled out in 2010. As Argentina's economy grew, so did the subsidies. They increased from 4.7 billion pesos in 2005 to 82.1 billion in 2010, with more than half directed to "economic subsidies" (e.g., electricity, transportation, foods), as opposed to "social subsidies" (health, housing, education, AUH).[52] In 2013, the subsidies increased by 50%.

Néstor's Death and Cristina's Landslide Reelection

Néstor Kirchner died on October 27, 2010, from a heart attack. Argentina rallied to support the grieving widow. Cristina's popularity index rose to 57% in December 2010 (from just 36%, in October).[53] The following year turned out to be a difficult one on more than just a personal level for the president. Though commodity prices held up reasonably well (see **Exhibit 7**), inflation was taking its toll. With the dollar stable, complaints concerning the loss of competitiveness were made public. Jose Nucete, an 83-year-old olive exporter from La Rioja province, complained "the dollar goes up the stairs, while wages take the elevator." Although this generated problems for some exporters, workers undoubtedly experienced some benefits in the form of lower prices for tradable goods.

But the repercussions of the global financial crisis were far from over. Capital flight became an issue. In the first nine months of 2011, US$18 billion left the country, double the amount the year

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before. In addition to capital flight (and diminishing Central Bank reserves), 2011 also saw a substantially lower primary surplus than in 2010. In fact, the surplus fell 80% year over year in 2011. Part of the reason was an increase in public spending of 32% over the previous year. By the final months of 2011, Central Bank cash transfers financed almost 17% of government spending.

Despite concerns about capital flight, inflation, and corruption,[54] the October 2011 reelection turned out to be a breeze for the incumbent candidate. Facing six opponents in the first round of voting,[55] Kirchner managed a resounding first-round 54.1% victory, the highest winning percentage since Argentina's return to democracy in 1983. Meanwhile, Elisa Carrió, again running on a transparency platform, garnered just 1.8% of the votes. This was surprising to many onlookers, as corruption accusations were common, and the president had difficulty explaining the dramatic increase in her net worth (from 7.4 million pesos in 2003 to over 70 million in 2011).[d]

The week after her reelection victory, Cristina Kirchner announced a series of currency controls. The objective was to stem capital flight and preserve the Central Bank's dollar reserves. Rules were opaque, and many currency-exchange houses shut their doors in the subsequent days because implementation was so onerous. Early in 2012, the government also introduced strict import controls in an effort to correct Argentina's tipping trade balance and save domestic jobs. Starting on February 1, 2012, all imports also had to be preapproved by AFIP. Some businesses relying on imported goods were forced to shut down as their requests went unanswered or were rejected.[56] The United States and the European Union were among the trade partners to file complaints with the World Trade Organization (WTO) over Argentina's infraction of accepted international trade practices.

Energy crisis[57] Argentina's trade balance for oil and gas flipped from a US$6 billion surplus in 2006 to a US$7 billion deficit in 2014 (see **Exhibit 15**). Several factors contributed to the lack of investment in the energy sector. Since 2002, the government had put a freeze on gas prices in an attempt to control inflation. Oil prices were also regulated, with exports capped at US$42 per barrel through an aggressive export tax regime. Argentina's proven oil and gas reserves experienced a drop of 33% between 1999 and 2011, with YPF's reserves dropping twice that figure (see **Exhibit 14a**).

In 2011, YPF announced the discovery of an important basin of shale oil and gas in the province of Neuquén, in an area called Vaca Muerta. It represented the third-largest reserve of oil and gas in the world. This discovery opened a new strategic opportunity both for the energy sector in Argentina and for the country as a whole. The hurdle would be obtaining the resources necessary to make Vaca Muerta operational. In financial resources alone, it was estimated that US$35 billion was going to be required over a five-year period.

Increasingly concerned over this dollar drain, and unable to face future investments in Vaca Muerta, Cristina Kirchner sent a bill to Congress on April 16, 2012, to renationalize YPF. The bill passed with overwhelming support. It specifically targeted shares owned by the Spanish company Repsol, leaving YPF's other owners untouched. The federal government would control 26.01%, while an additional 24.99% would be under the collective control of the hydrocarbon-producing provinces. A year later, Kirchner announced that YPF had closed a deal with Chevron for a US$1.5 billion investment for developing Vaca Muerta, the details of which were not disclosed (beyond a provision exempting Chevron from export taxes).

"Dollar clamp" In October 2011, the government increased restrictions on the access to dollars. Companies were allowed to purchase dollars at a level "compatible" with their net worth.[58] The

[d] During a 2012 visit to Harvard, and in response to question by a student, she explained, "I was a successful lawyer."

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Central Bank kept expanding the restrictions: in August 2012, the requirements for accessing dollars for tourism increased even further, and a 15% withholding tax (applicable toward yearly income tax returns) was levied on all foreign currency transactions made with a credit card issued in Argentina.[59] These restrictions also impacted the real estate sector: transactions in the main market declined 34% in the first seven months of 2013.

As Argentines watched inflation ravage their peso savings, often by more than 25% a year, they were willing to pay prices far above the official exchange rate to save in dollars. The gap between the official vs. market dollar continued to increase (see **Exhibit 5a**).[60] In September 2013, dollar reserves at the Central Bank dropped below US$35 billion (from US$52.3 billion in January 2011), while the amount of pesos in the economy continued to increase. In 2011, the dollar reserves were worth about 1.3 times as much as the monetary base at the official exchange rate. Since then, the ratio had dipped steadily, settling at around 0.61 in September 2013. Some observers estimated that Central Bank reserves would keep dropping, in part due to the schedule of payments of public debt, with cancellations for US$450 million due in October 2013, but mostly because of the rise in government spending. According to Orlando Ferreres, a private economic analyst, government spending as a percentage of GDP had risen from 28% to 45% between 2003 and 2012, and this was financed, in part, by printing money (see **Exhibit 16** for Argentine taxation rates). The year 2012 was also the first year since 1996 that the government presented a primary fiscal deficit.

In October 2013, the government obtained 33% of the votes in interim elections, an almost 20-point drop relative to the presidential vote, but still the largest political force. With the end of her presidency scheduled for the end of 2015, Kirchner's government soon focused its energies on preserving its dollar reserves. With the country in default, and the vulture funds bent on interfering with Argentina's repayment of the restructured debt, new loans were not forthcoming.

The drop in commodity prices during 2014 reduced Argentina's income from exports (particularly soybean and soybean oils) by US$4.5 billion relative to 2013. This was serious, given Argentina's historic trade deficit in industrial products (of approximately US$25 billion once energy was included). Worried by the country's dwindling dollar reserves—set at just under US$29 billion, enough to cover five months of imports—the Central Bank rushed the second installment of a currency swap with China. Cut off from capital markets, Kirchner had signed a US$11 billion loan with China in July 2014 that was now being disbursed.

The government made it more difficult to access dollars. Importers experienced difficulties in fulfilling their obligations (by January 2015, conservative estimates put these "delays" in payments to foreigners at around US$3 billion). These restrictions began seriously affecting imports, and this in turn affected economic activity. In December 2014, automotive industries experienced some relief when their quota was increased.[61] Other sectors were less favored. One common drawback was that the government was now requiring more information (regarding shareholders, investment plans) before approving purchases of dollars. The country was heading for a recession predicted to peak in 2015, even as the unofficial inflation exceeded 35%.[62]

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Land of Contrasts and Frustrations

Argentina's historical contrasts continued to prevail. The country's recent economic performance was solid, according to several indicators. Yet, professional economists were critical of the policies chosen during Argentina's remarkable recovery. Protectionism, foreign exchange controls, nationalizations, heavy subsidies, and heavy-handed debt renegotiations all seemed to be taken out of a "bad practices" book. Finally, Argentina's dollar reserves were catching up. Without access to international debt markets, Argentina would have to look internally for resources to keep its economy chugging. Would that be enough?

Jacinta Mazzoni shook her head. She wanted to be able to exercise her property rights and freedom of choice, and she figured that Argentina should be able to provide both. She wondered whether returning home after HBS had been the right decision.

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Table A Argentina's Debt Timeline

May 2001	A "megaswap" of Argentine bonds, aimed at giving the country breathing space to resume growth by stretching out the government's principal and interest payments, was concluded, with nearly $30 billion worth of bonds exchanged.
December 2001	Argentina declared a moratorium on its debt payments amid the worst economic and social crisis in its modern history. It triggered what at the time was the largest sovereign default ever, of around US$100 billion. "Argentina inaugurated its third president in four days yesterday and he immediately declared the biggest debt default in history, halting payments on the £94 billion the country owes."[63]
September 2003	Argentina and IMF agreed on debt-refinancing deal under which Buenos Aires would only pay interest on its loans.
March 2005	President Kirchner declared the restructuring of the country's debt to be a success. Argentina offered to exchange more than $100 billion in defaulted bonds. "The giant debt swap is epic in scale. It involves 152 varieties of paper denominated in six currencies. These bonds will now be exchangeable for three new issues. On March 1st, Néstor Kirchner, Argentina's president, declared the restructuring a triumph, claiming 'at least 70–75%' of bondholders had accepted it."[64]
June 2010	Argentina's creditors agreed to new debt swap deal worth around $12 billion. Under the agreement, two-thirds of the country's outstanding bad debt would be exchanged for new bonds. A small group of investors refused to tender their defaulted bonds for new securities and sought full repayment legally.
November 2010	"In order to . . . [prevent future crises], standardized and identical collective action clauses (CACs) will be included . . . in the terms and conditions of all new euro area government bonds."[65]
February 2012	New York District Court Judge Thomas Griesa ordered an injunction barring Argentina from making payments to exchange bondholders if it didn't also make "equal treatment" payments to a group of litigant holdout creditors led by Elliott Management and Aurelius Capital. "Argentina says it has been restricted from paying the holdout investors by the Rights Upon Future Offers, or RUFO, clause in its restructured bonds. The clause requires that Argentina give restructured bondholders equal treatment to the holdouts."[66]
March 2012	Judge Griesa issued a stay on the injunction pending further hearing of the issue at appeal. This bought time for Argentina, allowing it to keep paying exchange bondholders without paying the holdouts.
October 2012	The Second Circuit Court of Appeals in New York upheld the District Court decision on equal treatment and endorsed the injunction on payments.
November 2012	Judge Griesa reissued the injunction forcing Argentina to obey the court order that holdouts be treated equally.
February 2013	Parties made oral arguments before a three-judge panel in Second Circuit court. Argentine bonds fell sharply as market perceived the risk that it might default on its exchange bonds. "Jonathan Blackman, the attorney for the South American nation, said yesterday that Argentina would default on its restructured debt if it's forced by a three-judge appeals panel in New York to pay holders of the defaulted debt."

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	"'So the answer is you will not obey any order but the one you propose?' U.S. Circuit Judge Reena Raggi asked Blackman during more than two hours of arguments." "'If that's the confrontation the court seeks with the injunctions, that is the court's decision,' Blackman said. 'We're representing a government and governments will not be told to do things that fundamentally violate their principles.'"[67]
March 2013	The appeals court ordered the Argentine government to submit a proposal for paying the holdouts by March 29. One hour before midnight deadline, Argentina presented a proposal for paying holdout creditors. The offering was similar to previous debt exchanges and valued by analysts far below the holdouts' total claim.
April 2013	Holdout creditors rejected Argentina's proposal to pay them about 20 cents on every U.S. dollar of bonds they owned, leaving a U.S. appeals court to decide whether Argentina's proposal complied with the lower-court ruling that holdout creditors must be treated the same as investors who held its restructured bonds.
February 2014	Argentina again appealed to the Supreme Court, asking it to reverse the lower-court rulings. Axel Kiciloff, the Finance Minister, stated: "It was a snowball and we melt it: it became a little ball."[68]
June 2014	The U.S. Supreme Court rejected Argentina's appeal. Kiciloff announced his denial to negotiate with vulture funds: "They go after everything, they won't come through. If Argentina was obliged to pay the holdouts, the country will be pushed into a default."[69]
July 2014	Argentina defaulted on its international debt for the second time in 13 years, after failing to resolve its differences with U.S. hedge funds that held $1.3 billion worth of bonds, bought at a discount after the country last defaulted. "Standard & Poor's lowered Argentina's sovereign debt to 'selective default' during the negotiation that took place in New York between government officials and vulture funds, holders of the defaulted bonds."[70] "The official speech during that interim, was made explicit by the last public interventions from the President: Argentina deposited the money, so it is not in default. Furthermore, it has not made payment proposals to 'vultures' that may be considered to violate the RUFO clause."[71]
September 2014	Argentina's Congress approved a bill to restructure the country's debt and sidestepped a recent U.S. court ruling that caused Argentina to default. "Cristina Kirchner, in recent days, had highlighted the contrast between rating agencies such as Standard & Poor's, Fitch and Moody's—which she described as members of the vulture funds interested in the country having financial difficulties—and the support from various forums and organizations around the world."[72] The Finance Minister criticized the decision of Thomas Griesa: "It is a new example of inconsistency."[73]

Sources: *Wall Street Journal*, Bloomberg, Business Insider.

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Exhibit 1 Map of Argentina

Source: Courtesy of the University of Texas Libraries, The University of Texas at Austin, Perry Castañeda Library Map Collection, http://www.lib.utexas.edu/maps/, accessed May 2013.

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Exhibit 2 Selected Macroeconomic Indicators, 1997–2013

Concept	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total population (millions)	35.7	36.1	36.5	36.9	37.3	37.7	38.0	38.3	38.7	39.0	39.4	39.7	40.1	40.4	40.8	41.3	41.7
GDP (constant 2000 US$ billions)	286	297	286	284	272	242	263	287	314	340	370	395	398	434	473	477	475
GDP per capita (constant 2000 US$)	7,994	8,205	7,840	7,696	7,283	6,428	6,933	7,492	8,108	8,717	9,389	9,936	9,933	10,749	11,602	11,560	11,400
Agriculture, value added (% of GDP)[a]	5.6	5.6	4.7	5.0	4.8	10.7	11.0	10.4	9.4	8.4	9.4	9.8	7.5	10.0	9.1	9.1	9.3
Industry, value added (% of GDP)	29.1	28.6	27.8	27.6	26.6	32.0	34.7	35.6	35.6	35.6	33.7	32.3	31.8	30.9	26.3	30.5	29.7
Services, etc., value added (% of GDP)	65.3	65.8	67.4	67.4	68.6	57.3	54.3	54.0	55.0	56.0	56.9	57.9	60.7	59.1	64.6	60.4	61.0
Exports of goods+services (% of GDP)	10.5	10.4	9.8	10.9	11.5	27.7	25.0	25.3	25.1	24.8	24.6	24.5	21.4	21.7	21.8	19.7	20.3
Imports of goods+services (% of GDP)	12.8	12.9	11.5	11.5	10.2	12.8	14.2	18.2	19.2	19.2	20.3	20.7	16.0	18.4	19.5	17.4	18.9
Poverty headcount ($2/day, PPP,%)[b]	7	8	9	11	15	23	18	12	9	7	5	4	3	2	..	..	
Unemployment rate (%)	13.4	12.1	13.5	14.7	18.1	17.5	16.8	13.6	11.6	10.2	8.5	7.9	8.7	7.8	7.5	7.2	7.5
GINI index (0-100)[c]	49	51	50	51	53	54	55	50	49	48	47	46	46	44	..	..	
Life expectancy at birth (years)	73	73	74	74	74	74	74	75	75	75	75	75	75	76	76	..	
Consumer prices (p.a. % change)[d*]	1	1	-1	-1	-1	26	13	4	10	11	9	9*	6*	11*	9*	10*	
Official FX rate (ARS per USD, a.a.)[e]	1.00	1.00	1.00	1.00	1.00	3.06	2.90	2.92	2.90	3.05	3.10	3.14	3.71	3.90	4.11	4.58	
Foreign currency reserves (US$ billions)[f]	29.8	31.7	33.1	34.2	15.2	10.5	14.1	19.6	28.1	32.0	46.2	46.4	48.0	52.1	46.4	..	

Source: International Financial Statistics (IFS) via the IMF eLibrary; World DataBank; World Development Indicators (WDI); and Global Development Finance.

Note: Current (or nominal) figures are presented in the value of the U.S. dollar for that particular year, while constant (or real) figures present the data in reference to the value of the U.S. dollar for the base year (2000). (For GDP growth, see **Exhibit 3**, below.)

[a] Per the WDI, value added is the net output of the sector (agriculture, industry, services, etc.) after adding up all outputs and subtracting intermediate inputs. It is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources.

[b] Per the WDI, this is the percentage of the population living on less than $2.00 a day at 2005 international prices. Not all years have data available.

[c] The GINI index measures the extent to which the distribution of income within an economy deviates from equal distribution, with 0 representing perfect equality and 100 perfect inequality.

[d] The consumer price data from 2007 to 2011 was allegedly tampered with by the government.

[e] The values here are the average FX rate for the year indicated (a.a. = annual average).

[f] Foreign currency reserve totals at the end of the year indicated.

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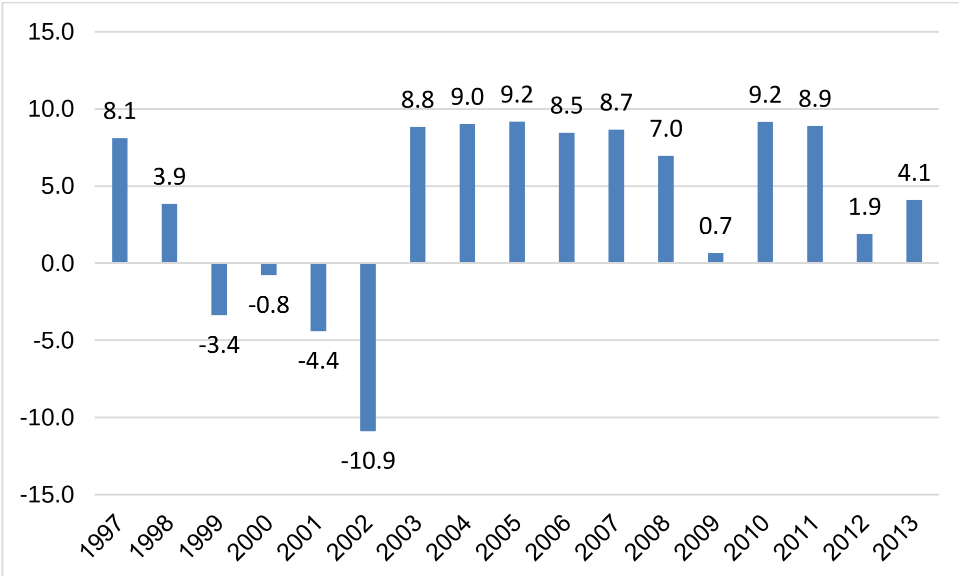
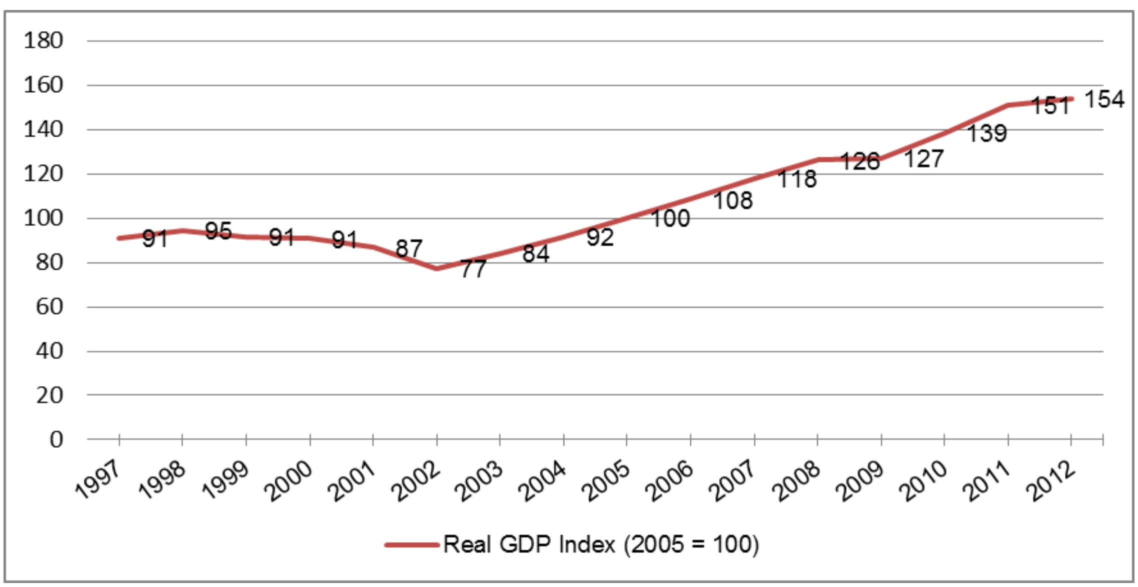
Exhibit 3a Real GDP Annual Growth (%) in Argentina, 1997–2013



Source: International Monetary Fund (IMF), International Financial Statistics (IFS) database, based on INDEC's quarterly bulletin of statistics; 2013 data from www.euromonitor.com/Argentina, accessed October 20, 2013.

Note: Real GDP measured in Argentine pesos at 1993 prices.

Exhibit 3b Real GDP Index, 1997–2012 (2005 = 100)



Source: IMF's IFS data, based on INDEC's quarterly bulletin of statistics.

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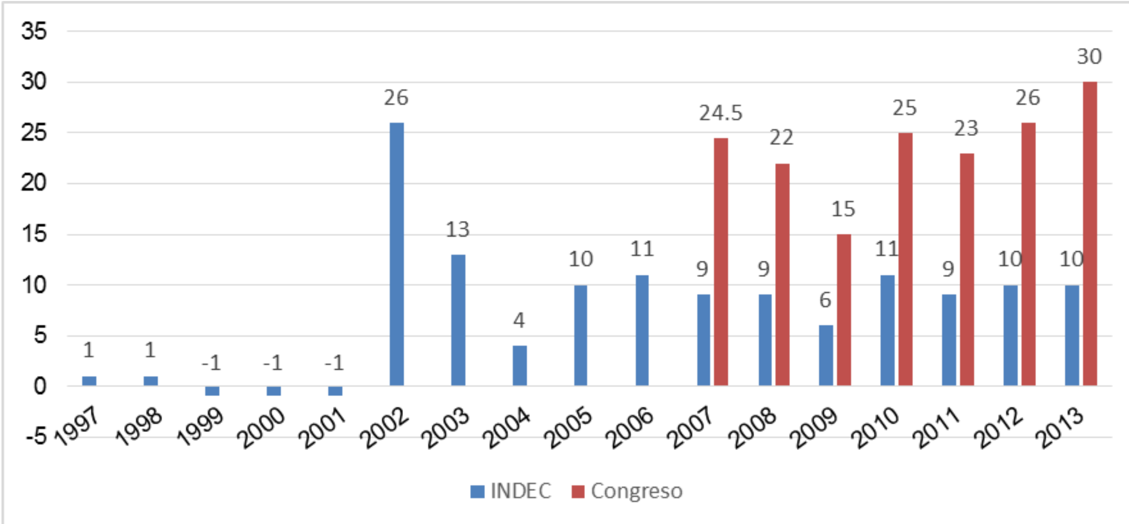
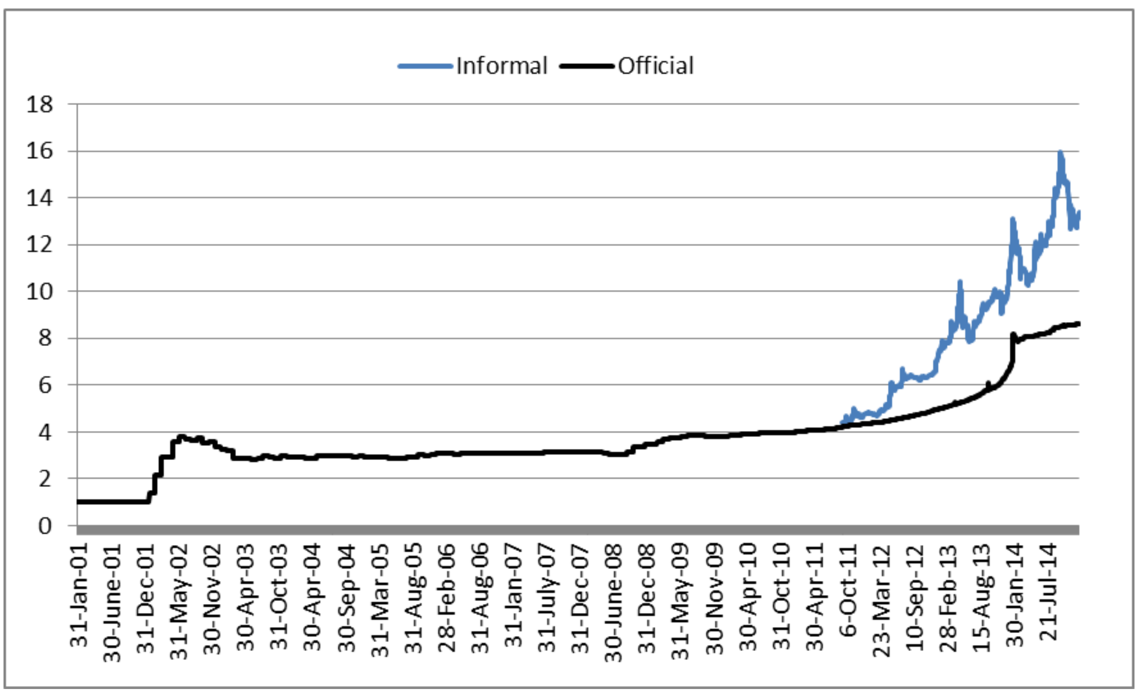
Exhibit 4 Argentina's Annual Inflation (% change), 1997–2013



Source: IMF's IFC statistics, from INDEC; for 2013, *Clarín*, Buenos Aires, September 12, 2013; Presupuesto, 2014.

Note: Inflation rate Congreso is calculated by private economists.

Exhibit 5a Formal and Informal U.S. Dollar Exchange Rates in Argentine Pesos



Source: Thomson Datastream and Bloomberg, accessed February 5, 2013.

Note: See **Figure A** on p. 2 for the real exchange rate, 1984–2012.

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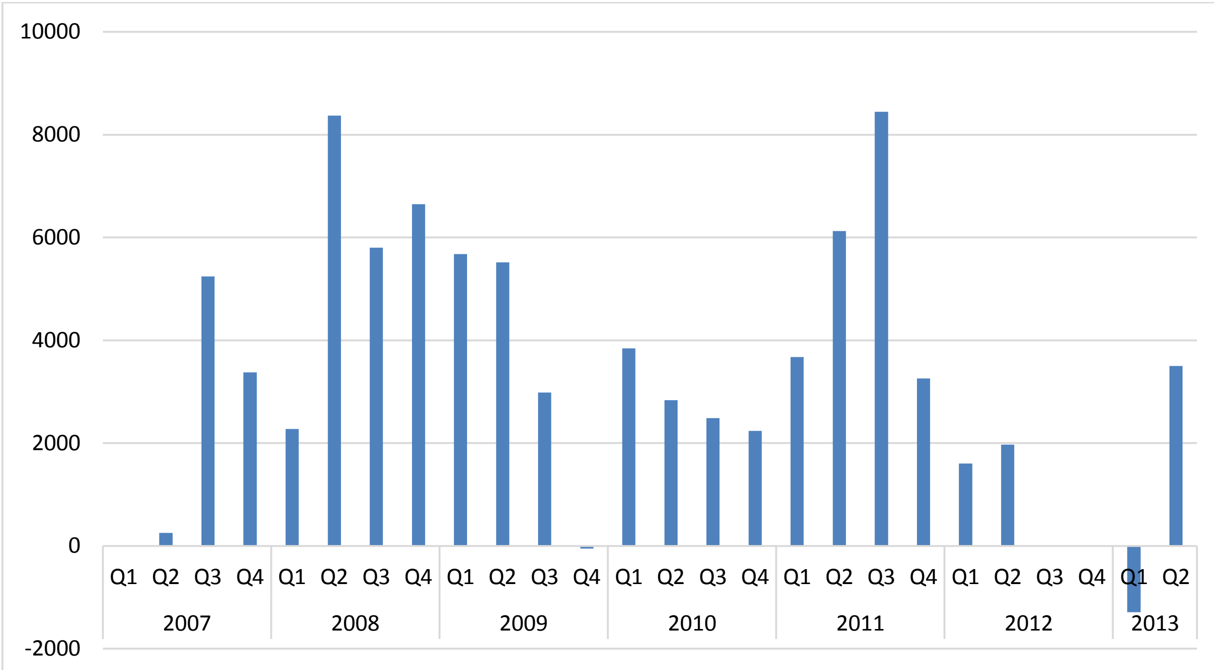
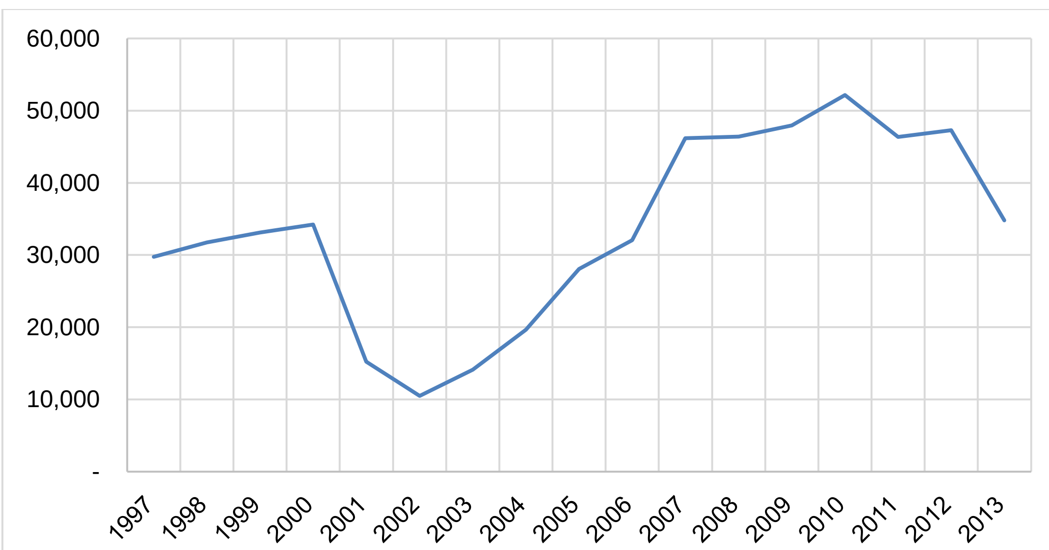
Exhibit 5b Capital Outflows, 2007–2013 (by quarter)



Source: Central Bank of Argentina; www.reuters.com for 2012 data; and www.bloomberg.com for 2013 data, accessed November 27, 2013.

Exhibit 6 Central Bank International Reserves, 1997–2012 (US$ million)



Source: Year-end international reserves data from the Central Bank of the Republic of Argentina (BCRA); for 2013, month-end September data from www.bcra.gov.ar, accessed October 2, 2013.

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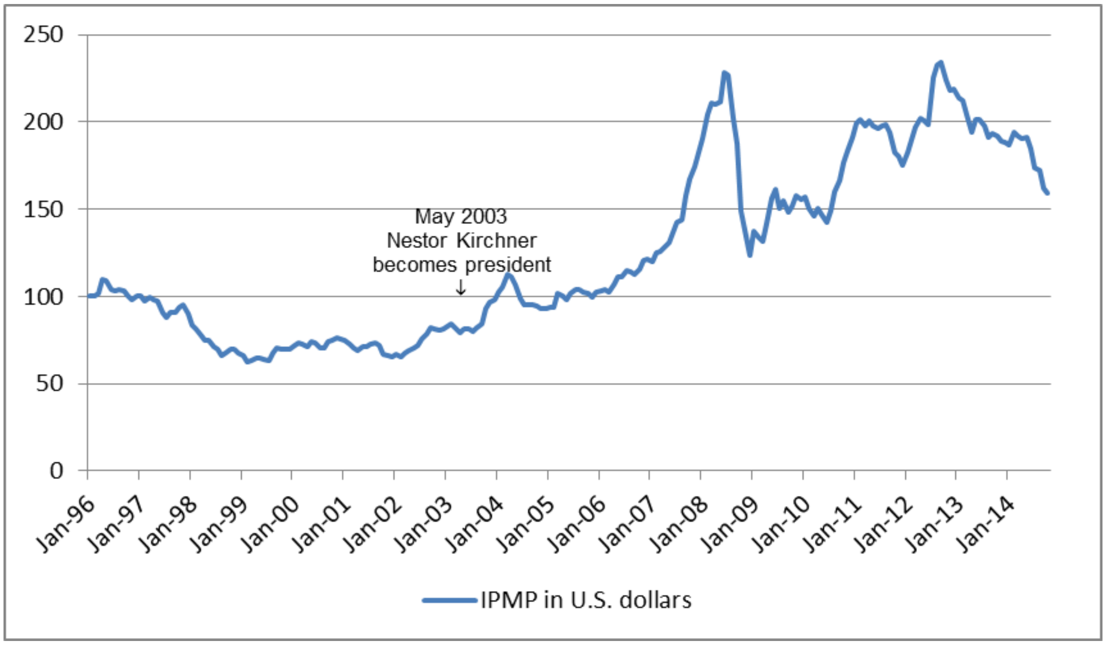
Exhibit 7 Index of Commodity Prices, 1996–2014 (December 1995 = 100)



Source: Central Bank of Argentina (BCRA), www.bcra.gov.ar/pdfs/indicadores/IPMPSerie_i.xls -, accessed December 2014.

Note: The Index of Commodity Prices (IPMP) aimed to summarize the Argentine export price dynamics. The index included the prices of the most important commodities for Argentine exports: maize, wheat, soybeans, soybean oil, soybean meal, beef, crude oil, metals, primary aluminum, and copper, which accounted for approximately 42.2% of total exports in 2011. As can be seen, the Index of Commodity Prices hits its lowest level in the first quarter of 1999 and in the second quarter of 2002. From that moment on, it began an upward trend. Since the middle of 2007, there was a marked fall in international prices of commodities, with a mean recovery during mid-2009. During 2010 and until mid-2011, there was a significant improvement reaching a new historical maximum in the third quarter of 2012. After that, there was a slight decline, although it should be noted that raw material prices still remain at historically high levels.

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Exhibit 8 National Income Accounts as a Share of GDP (%), 1997–2012

As a % of GDP	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Priv. Final Consumption	70.8	70.1	70.0	70.7	70.3	60.9	62.7	62.6	60.8	58.7	58.6	59.4	58.5	59.8	61.3	59.0
Pub. Final Consumption	12.1	12.5	13.7	13.8	14.2	12.2	11.4	11.1	11.9	12.4	12.9	13.4	15.2	14.9	15.1	17.0
Gross Fixed Captl Form	19.4	19.9	18.0	16.2	14.2	12.0	15.1	19.2	21.5	23.4	24.2	23.3	20.9	22.0	22.6	22.0
Exports of Gds+Svces	10.5	12.9	9.8	10.9	11.5	27.7	25.0	18.2	25.1	19.2	24.6	20.7	21.4	21.7	21.8	20.0
Imports of Gds+Svces	12.8	10.4	11.5	11.5	10.2	12.8	14.2	25.3	19.2	24.8	20.3	24.5	16.0	18.4	19.5	17.0
Nominal GDP (ARS, billions)	292.9	298.9	283.5	284.2	268.7	312.6	375.9	447.6	531.9	654.4	812.5	1,032.8	1,145.5	1,442.7	1,842.0	1,872.5

Source: World DataBank; World Development Indicators.

Note: Private (or household) final consumption expenditures, public (or general government) final consumption expenditures, gross fixed capital formation, exports of goods and services, and imports of goods and services are all displayed as a % of GDP. For reference, the nominal (or current) GDP is presented in the local currency unit (ARS, in billions) in the final line above.

Exhibit 9 Budgetary Indicators as a Share of GDP (%), 1997–2013

% of GDP	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Budget expenditure	20	20	22	22	22	19	20	21	22	22	19	20	23	24	25	28	31
Budget revenue	19	19	20	20	19	18	21	23	24	24	20	21	23	24	24	25	27
Budget balance	-1.5	-1.4	-1.7	-2.4	-3.2	-1.5	0.5	2.6	1.8	1.8	1.1	1.4	-0.6	0.2	-1.7	-2.6	-3.3
Of which																	
Debt interest payments	2.0	2.2	2.9	3.4	3.8	2.2	1.8	1.3	1.9	1.8	2.0	1.7	2.1	1.5	1.9	2.4	2.5
Primary balance[a]	0.5	0.9	1.2	1.0	0.5	0.7	2.3	3.9	3.7	3.5	3.2	3.2	1.5	1.7	0.2	-0.2	-0.8
Public debt	35	38	43	45	54	146	138	126	73	64	56	49	49	45	42	45	46

Source: The Economist Intelligence Unit (EIU), using data from Argentina's Ministry of the Economy (Mecon) and the IMF's IFS database.

Note: There was a break in the series starting in 2007: Expenditure and revenue data no longer included the provinces.

[a] Primary balance represents revenues minus expenditures before debt interest payments.

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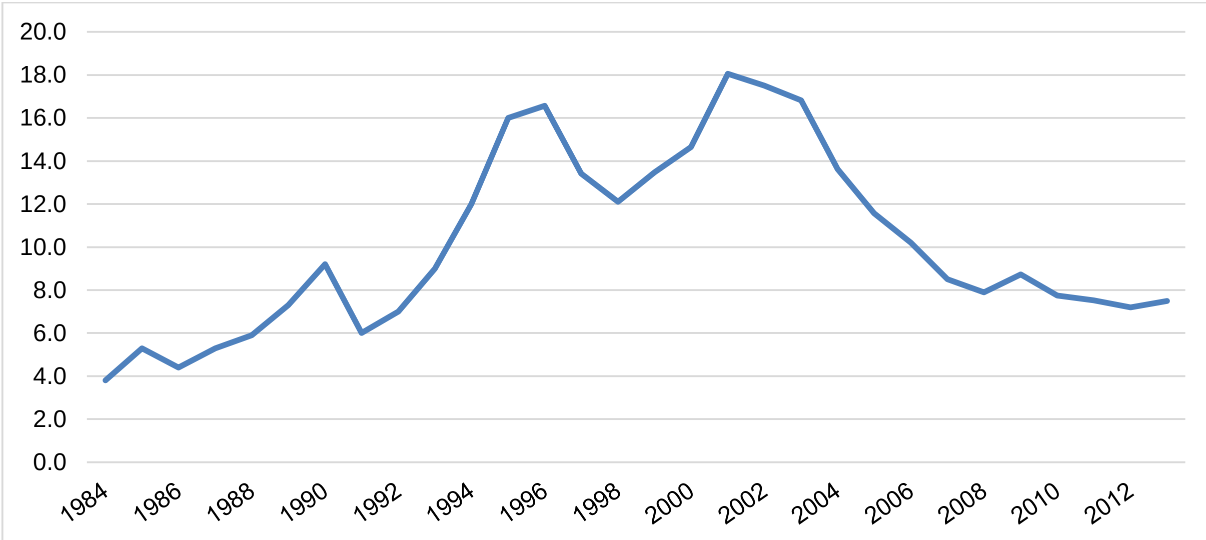
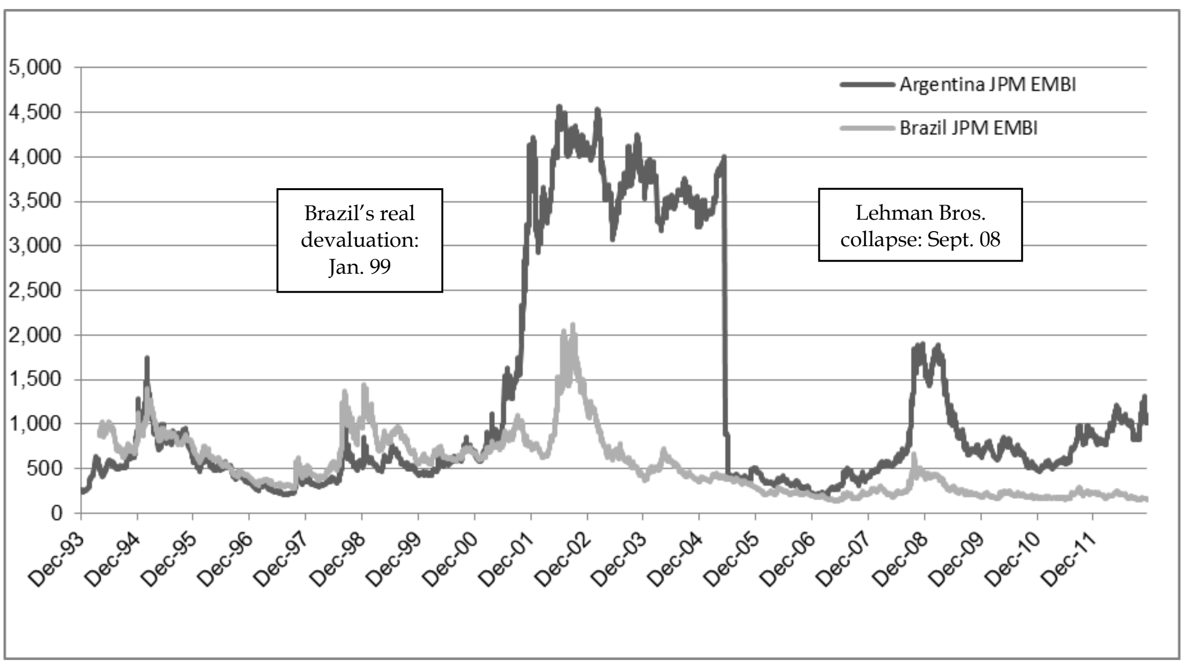
Exhibit 10 Annual Unemployment Rate, 1984-2013



Source: IMF's IFS data, from INDEC; 2013 data from www.eiu.com, accessed October 16, 2013.

Exhibit 11 J.P. Morgan Emerging Market Bond Indexes (monthly average EMBI)



Source: Thomson Datastream, accessed December 2012.

Note: The J.P. Morgan EMBI covers only Brady Bonds. One hundred basis points equals 1%.

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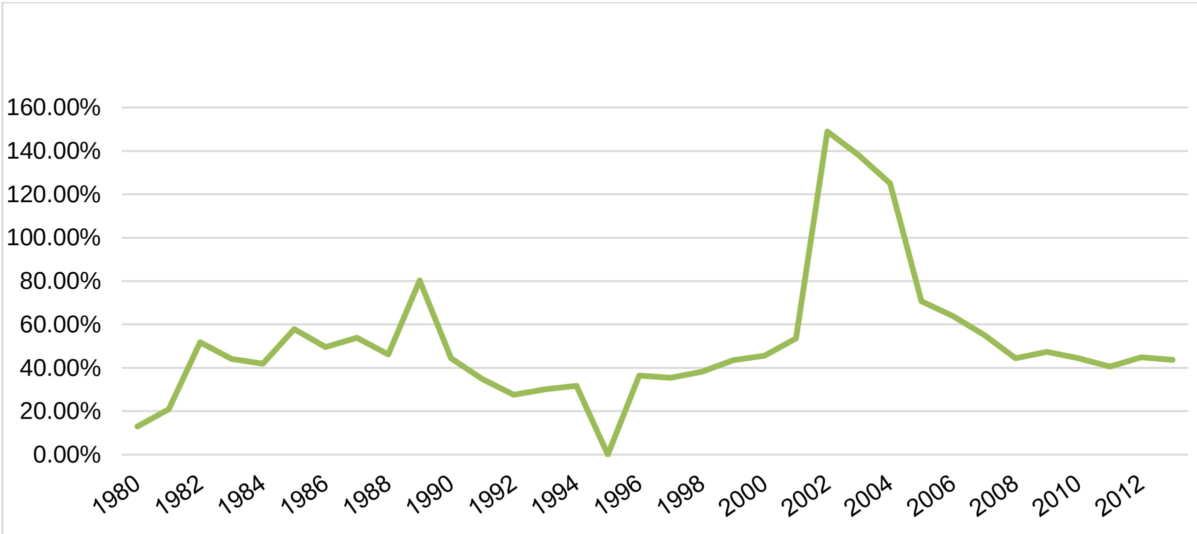
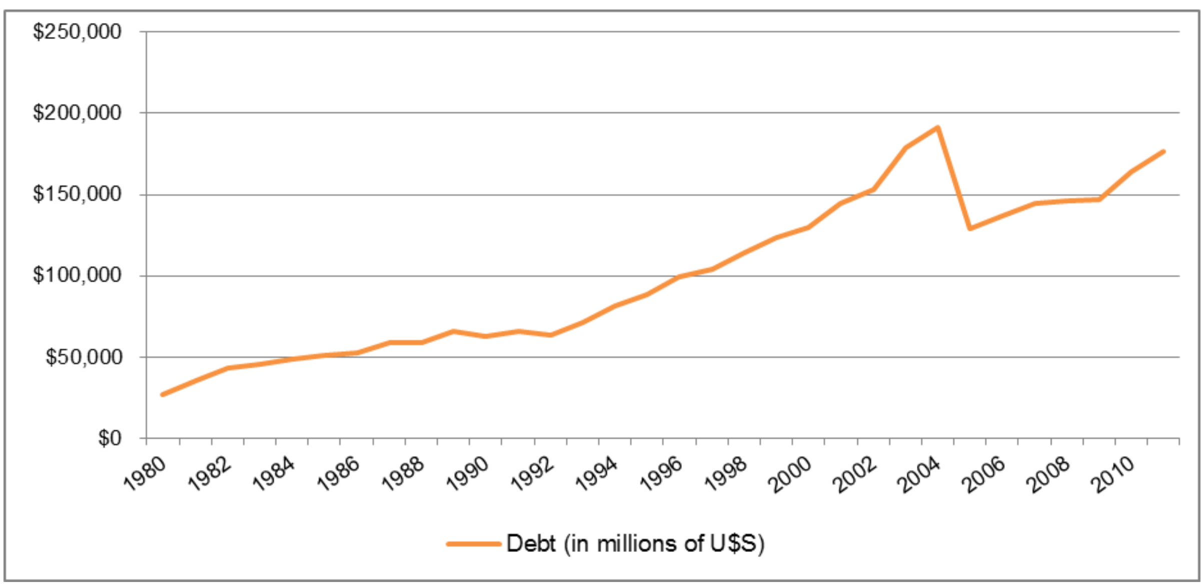
Exhibit 12a Debt as a Percent of GDP



Source: Compiled by CIPPEC (Centro de Implementación de Políticas Públicas para la Equidad y el Crecimiento), with debt data from Argentina's Ministry of Economy and Finance (MECON), *Boletin Fiscal*, and GDP data from the World Economic Outlook Database, September 2013.

Exhibit 12b Outstanding Debt (in millions of US$)



Source: CIPPEC (Centro de Implementación de Políticas Públicas para la Equidad y el Crecimiento), with debt data from Argentina's Ministry of Economy and Finance (MECON), *Boletin Fiscal*.

Note: Public debt figures as of June 30, 2011.

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Exhibit 12c Selected Net Public Debt (% of GDP)

Country	2007	2012E
Argentina	67.1	45.2
Brazil	65.2	64.1
Chile	26.0	11.4
France	64.2	90.0
Germany	65.4	83.0
Greece	107.4	170.7
Italy	103.1	126.3
Mexico	37.6	43.1
Spain	36.3	90.7
United Kingdom	43.7	88.7
United States	67.2	107.2

Source: World Economic Outlook, International Monetary Fund, October 2012.

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Exhibit 13 Balance of Payments Estimates for 1997–2012 (US$ million)[a]

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Current Account	**-12,116**	**-14,465**	**-11,910**	**-8,955**	**-3,780**	**8,767**	**8,140**	**3,212**	**5,274**	**7,768**	**7,354**	**6,756**	**10,995**	**2,818**	**-1,568**	**479**
Goods	-2,123	-3,097	-795	2,452	7,385	17,178	16,805	13,265	13,087	13,958	13,456	15,423	18,526	14,266	13,207	15,642
Exports fob	*26,431*	*26,434*	*23,309*	*26,341*	*26,543*	*25,651*	*29,939*	*34,576*	*40,387*	*46,546*	*55,980*	*70,019*	*55,672*	*68,134*	*83,950*	*81,205*
Imports fob	*28,554*	*29,531*	*24,103*	*23,889*	*19,158*	*8,473*	*13,134*	*21,311*	*27,300*	*32,588*	*42,525*	*54,596*	*37,146*	*53,868*	*70,743*	*65,563*
Services	-4,385	-4,444	-4,111	-4,284	-3,863	-1,460	-1,193	-1,331	-992	-501	-513	-1,284	-1,285	-1,114	-2,238	-3,460
Exports	*4,599*	*4,854*	*4,719*	*4,936*	*4,627*	*3,495*	*4,500*	*5,288*	*6,634*	*8,023*	*10,363*	*12,156*	*10,967*	*13,066*	*15,606*	*15,239*
Imports	*8,984*	*9,298*	*8,830*	*9,219*	*8,490*	*4,956*	*5,693*	*6,619*	*7,626*	*8,523*	*10,876*	*13,440*	*12,252*	*14,180*	*17,844*	*18,699*
Income	-6,123	-7,387	-7,457	-7,522	-7,727	-7,491	-7,975	-9,283	-7,305	-6,150	-5,942	-7,552	-8,955	-9,939	-11,999	-11,307
Investment income	-6,119	-7,383	-7,468	-7,530	-7,731	-7,466	-7,950	-9,244	-7,254	-6,090	-5,870	-7,494	-8,887	-9,881	-11,951	-11,261
Interests	*-4,199*	*-5,090*	*-5,852*	*-5,921*	*-7,473*	*-7,696*	*-7,317*	*-6,956*	*-3,359*	*-1,151*	*-629*	*-1,400*	*-2,260*	*-2,722*	*-3,367*	*-3,053*
Profits and dividends	*-1,920*	*5,257*	*-1,616*	*-1,609*	*-258*	*230*	*-633*	*2,818*	*-3,895*	*3,993*	*-5,241*	*4,205*	*-6,627*	*-7,159*	*-8,584*	*-8,208*
Other Income	-4	10,347	11	8	4	-25	-26	9,774	-51	5,143	-72	5,605	-68	-58	-48	-46
Current Transfers	515	-2,293	453	399	424	540	504	-2,287	484	-4,939	353	-6,094	2,710	-396	-539	-397
Capital & Financial Account	**17,709**	**18,354**	**13,772**	**8,732**	**-5,442**	**-11,404**	**-3,173**	**1,574**	**3,472**	**-5,401**	**5,680**	**-7,809**	**-9,313**	**2,362**	**-947**	**-3,436**
Capital Account	66	73	149	106	157	406	70	196	89	97	121	181	74	89	62	38
Financial Account	17,643	18,281	13,623	8,626	-5,598	-11,810	-3,243	1,378	3,383	-5,498	5,559	-7,990	-9,387	2,273	-1,010	-3,475
Banking Sector	-909	3,505	1,330	67	11,588	-2,573	-3,001	-3,097	-4,356	-10,508	1,583	1,733	-969	-2,566	6,900	-1649
Central Bank	*-586*	*-512*	*-1,033*	*762*	*10,743*	*-1,808*	*-868*	*-1,990*	*-2,922*	*-10,400*	*1,493*	*1,823*	*-1,404*	*-2,910*	*5,000*	*-2,000*
Other financial entities	*-323*	*4,017*	*2,363*	*-695*	*845*	*-765*	*-2,133*	*-1,107*	*-1,434*	*-108*	*90*	*-90*	*434*	*344*	*1,900*	*351*
Nonfin. Public Sector	8,163	9,361	10,886	8,253	-3,388	3,618	4,641	4,974	3,428	3,437	2,404	-517	-732	2,209	-2,336	-3895
National Government[b]	*6,806*	*9,525*	*10,108*	*7,409*	*-2,926*	*3,683*	*4,739*	*5,043*	*3,344*	*2,957*	*2,158*	*-298*	*-632*	*486*	*-3,439*	*-4,113*
Local Governments	*1,733*	*149*	*1,364*	*1,276*	*-59*	*237*	*167*	*191*	*334*	*809*	*448*	*-102*	*-65*	*1,784*	*1,163*	*255*
Companies and other	*-376*	*-313*	*-586*	*-433*	*-404*	*-302*	*-265*	*-260*	*-251*	*-329*	*-202*	*-117*	*-35*	*-61*	*-61*	*-36*
Nonfin. Private Sector	10,389	5,414	1,407	305	-13,798	-12,856	-4,882	-499	4,311	1,573	1,572	-9,206	-7,685	2,630	-5, 745	2,069
Net Errors & Omissions	-2,321	-451	-662	-216	-2,861	-1,878	-1,387	533	111	1,163	63	1,062	-336	-1,023	-3,592	-347
Intern´l Reserves Variation	3,273	3,438	1,201	-439	-12,083	-4,516	3,581	5,319	8,857	3,530	13,098	9	1,346	4,157	-6,108	-3,305
BCRA Intern´l Reserves	*3,062*	*3,442*	*1,093*	*-424*	*-12,005*	*-4,437*	*3,643*	*5,527*	*8,431*	*3,960*	*14,139*	*210*	*1,582*	*4,222*	*-5,814*	*-3,086*
FX adjustment	*-211*	*4*	*-108*	*15*	*79*	*79*	*62*	*208*	*-426*	*430*	*1,041*	*201*	*235*	*65*	*294*	*219*

Source: INDEC, www.indec.gov.ar, accessed October 23, 2013.

[a] See **Exhibit 13 (addendum)** on next page for a brief description of one selected year—2001—highlighting some key figures in the current and financial accounts.

[b] BoP estimates incorporate the results of the debt swap from Q2 of 2005, effecting the current account balance and financial account. BoP estimates from Q2 of 2005 do not include accrued interest on the debt held by "holdouts." Also, Q2 of 2010 incorporates estimates of the flows generated by the close of the public debt swap realized June 2010 (Decree 563/10).

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Exhibit 13 (addendum) Spotlight on the Balance of Payments Presented for 2001

The current account: Argentina's current account deficit for 2001 was US$3.78 billion. That was considerably lower than the $8.90 billion deficit seen the year before (2000). The balance of trade for the year was positive at $3.52 billion. Indeed, the value of exported goods actually grew year over year, while the value of imported goods and services fell on lower demand amid Argentina's recession and currency crisis. Although the trade balance was often the dominant component of a country's current account, this was not the case with Argentina: it had a trade surplus that helped offset its income deficit. The negative investment income of –$7.73 billion was mostly due to Argentina's interest payments, paid out to organizations abroad. While Argentina declared that it would default on some of its debt in December 2001, it appeared to have made significant debt payments to international organizations throughout the turbulent year. A relatively small "current transfer" (i.e., a unilateral transfer) did little to counteract the red ink. With the current account deficit of $3.78 billion overall, Argentina continued absorbing (via domestic consumption, domestic investment, and government spending) more than it was producing. This might be expected to be accompanied by increased borrowing, but during the 2001 crisis, it was accompanied by decreased lending.

The capital and financial account: The capital and financial account outflows amounted to $5.44 billion in 2001, compared to inflows of $8.73 billion the year before. The outflows were concentrated in the fourth quarter of the year, the quarter in which the bank runs, currency controls, changes in government, abandoning of the Convertibility Plan, and declared debt default all occurred. The year still saw ample assistance from international organizations, especially during the first three quarters of 2001, under the auspices of the *blindaje* (armor) loan package orchestrated by De la Rúa. Disbursements of +$10.74 billion from the IMF, the World Bank, and the Interamerican Development Bank (BID, in Spanish) helped the banking sector end the year with +$11.59 billion in investment inflows. For the nonfinancial public sector—including parts of the national government, local governments, and other companies—new loan/bond placements dropped, while amortizing and repurchased loans/bonds contributed to the year's outflow of $3.39 billion. In the nonfinancial private sector, foreign direct investment (FDI) dropped considerably, while capital flight was apparent in the $13.8 billion net outflow.

"Net errors and omissions" were high for the year, at –$2.86 billion, which the government explained was due to the difficulty of capturing the rapidly changing value of portfolio items during this time. Argentina's Central Bank's foreign currency reserves were run down by $12.01 billion, a precipitous drop (also captured by **Exhibit 6**).

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Exhibit 14a Argentine and the YPF Hydrocarbon Reserves

	Repsol YPF[a]			Argentina		
Year	Oil[c] (mmbl)	Natural Gas[d] (bcf)	Total[e] (mmboe)	Oil[b] (mmbl)	Natural Gas[d] (bcf)	Total[e] (mmboe)
1999	1,667	10,683	3,570	2,753	25,744	7,044
2000	1,809	9,689	3,534	2,974	27,475	7,553
2001	1,768	11,501	3,817	2,879	26,980	7,376
2002	1,514	11,070	3,485	2,821	23,449	6,729
2003	1,351	8,685	2,898	2,675	21,648	6,283
2004	1,228	9,063	2,842	2,320	19,529	5,575
2005	875	7,160	2,150	2,320	15,503	4,904
2006	778	4,463	1,573	2,468	15,750	5,093
2007	668	4,112	1,340	2,587	15,538	5,177
2008	652	3,741	1,318	2,616	15,115	5,135
2009	657	4,512	1,460	2,520	14,091	4,868
2010	531	2,533	982	2,505	13,384	4,736
2011	585	2,361	1,004	2,505	12,678	
2012	591	2,222		2,805	11,760	

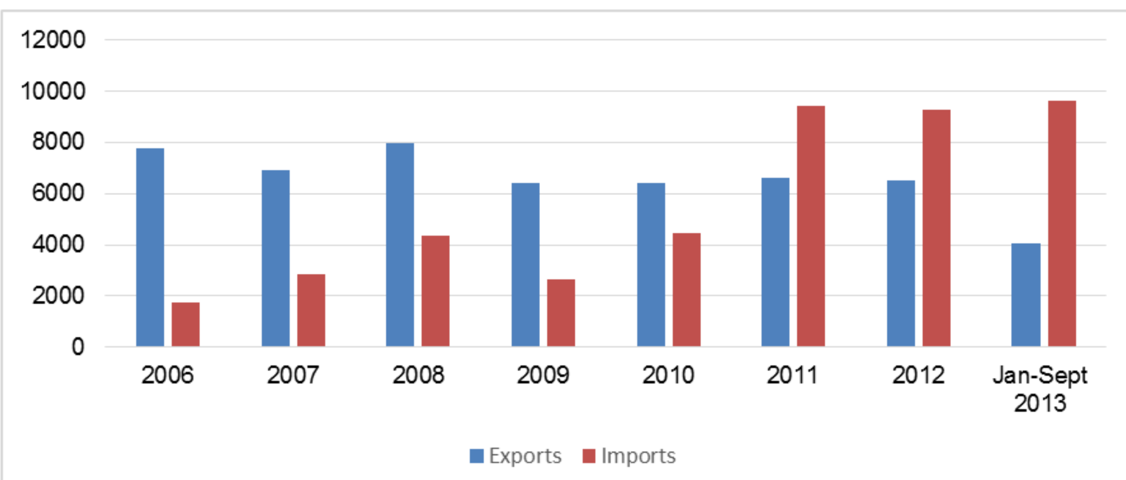
Source: (a) 20-F filings found in www.ypf.com, accessed October 14, 2013.
(b) OPEC, "World Proven crude oil," *Annual Statistical Bulletin*, p. 24, reserveshttp://www.opec.org/opec_web/en/publications/202.htm, accessed November 25, 2013; data for 2011 from *CIA World Fact Book*, www.cia.gov/library/publications/the-world-factbook.

[c] From 2002 to 1999, proved developed reserves of crude oil, condensed oil, and LPG.

[d] Proved developed reserves of natural gas in billions of cubic feet.

[e] Gas is converted to oil equivalent using a factor of 6,000 cubic feet per gas per 1 barrel of oil equivalent.

Exhibit 14b Energy Balance, 1990–2013



Source: INDEC, www.indec.gov.ar, accessed October 23, 2013.

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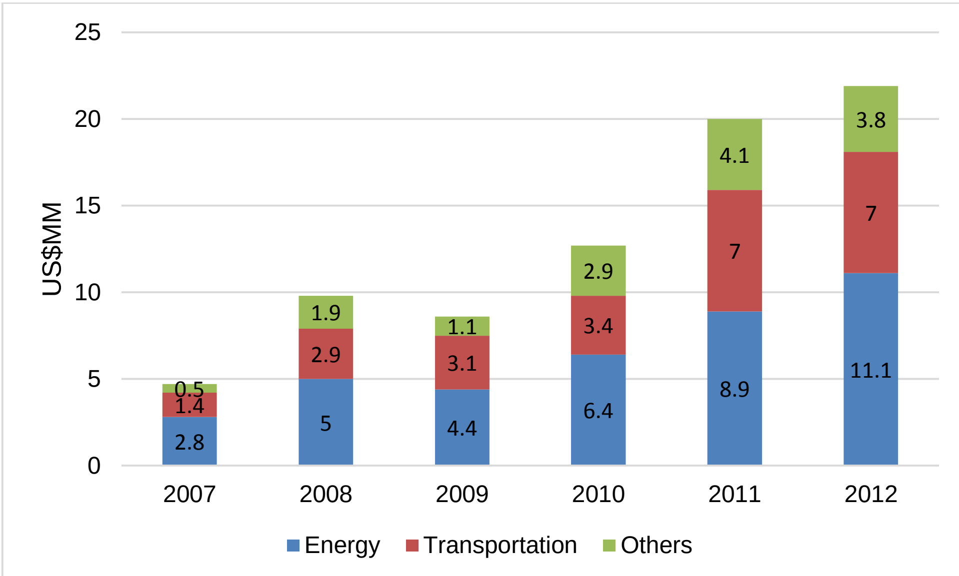
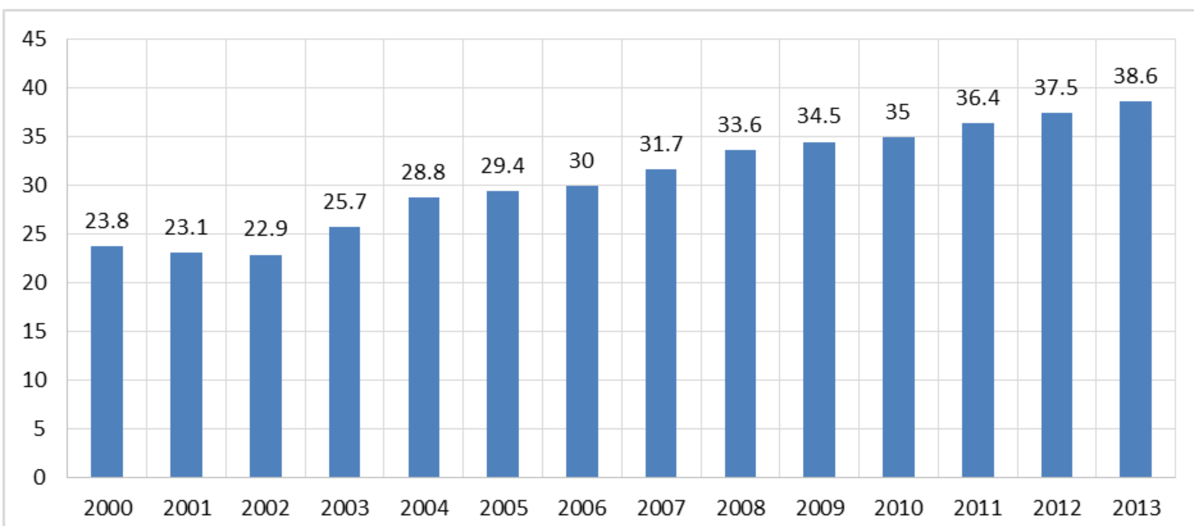
Exhibit 15 Evolution of Subsidies, 2007–2012



Source: Asociacion Argentina de Presupuesto y Administracion Financiera Publica, www.asap.org.ar.

Exhibit 16 Argentina Taxation Rate (% of GDP)



Source: Iaraf, www.iaraf.org, accessed October 28, 2013.

Note: 2013 estimated.

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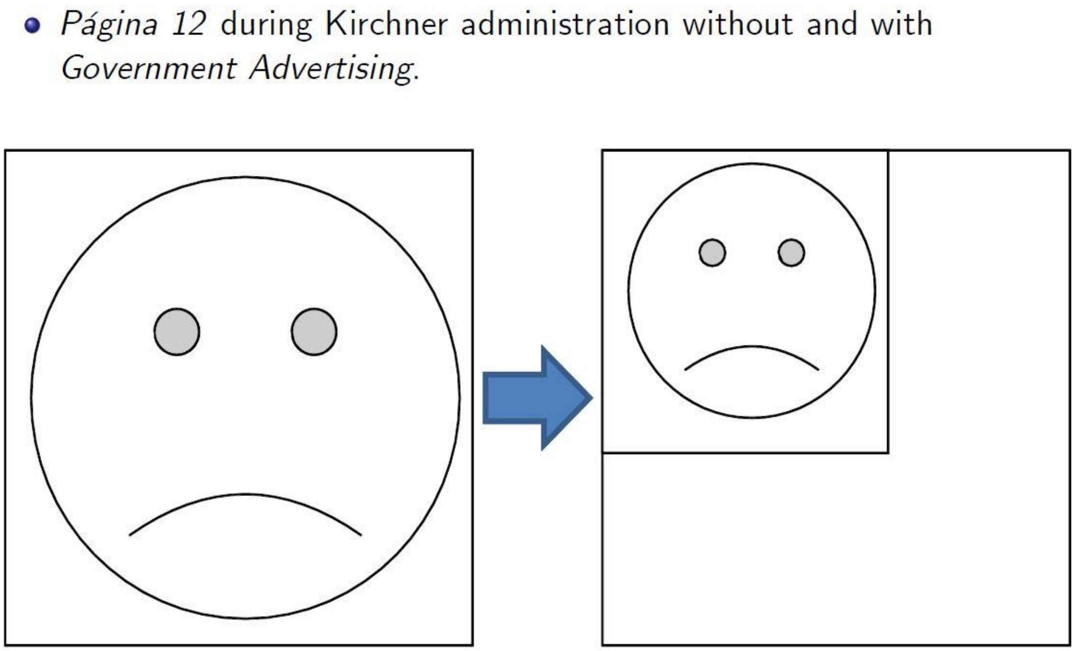
Exhibit 17 The Impact of Government Advertising on Negative Coverage



Source: Rafael Di Tella and Ignacio Franceschelli, "Government Advertising and Media Coverage of Corruption Scandals," *American Economic Journal: Applied Economics* 3, no. 4 (October 2011): 119–151.

Note: This is the estimated decline in front-page coverage (of government corruption) associated with an increase in transfers by the government (from one category: "*Publicidad oficial*") for the newspaper *Pagina 12*.

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Endnotes

[1] Administración Federal de Ingresos Públicos (AFIP) was formed in 1997 to enforce Argentina's tax and customs policies. See http://www.afip.gov.ar, accessed January 2012.

[2] However, after Cristina Kirchner's impressive election results, her popularity ratings slumped, according to reports by the Economist Intelligence Unit (EIU).

[3] The following paragraphs draw from: (a) Rafael Di Tella, "Menem and the Populist Tradition in Argentina," HBS No. 700-061 (Boston: Harvard Business School Publishing, 2000); (b) Rafael Di Tella and Ingrid Vogel, "Argentina's Convertibility Plan," HBS No. 702-002 (Boston: Harvard Business School Publishing, 2001); and (c) Rafael Di Tella and Ingrid Vogel, "The 2001 Crisis in Argentina: An IMF-Sponsored Default? (A)," HBS No. 704-004 (Boston: Harvard Business School Publishing, 2003).

[4] See Rafael Di Tella, Tarun Khanna, and Huw Pill, "Argentina's Financial System: The Case of Banco de Galicia," HBS No. 703-033 (Boston: Harvard Business School Publishing, 2002).

[5] *Ambito Financiero*, July 30, 2001.

[6] The $1,000 limit was set based on research that 99% of Argentines typically cashed less than that amount per month.

[7] Since the vice president had resigned, the head of the Senate assumed the presidency on a provisional basis. On December 23, 2001, Adolfo Rodríguez Saá, a former provincial governor, was elected president by Congress but ended up resigning on December 30, 2001, citing lack of support from his own Peronist Party.

[8] The Argentine president possesses two powers not enjoyed by his or her American equivalent. First, the Argentine president may issue executive orders that have the force of law (except regarding criminal matters, the regulation of elections, or taxation) unless Congress explicitly rejects them within six months. Second, the president may directly introduce tax and budget legislation to Congress, bypassing the committee system and going directly to a floor vote.

[9] Daily rate data available from http://www.oanda.com/convert/fxhistory.

[10] Georgios Theophanous, "Duhalde's dilemma: Argentina in crisis," *Harvard International Review*, Spring 2003.

[11] Data from Instituto Nacional de Estadistica y Censos (INDEC), *Encuesta Permanente de Hogares 1988–2003*.

[12] Hannah Baldock, "Child hunger deaths shock Argentina: Economic crisis sharpens poverty in world's fourth biggest food exporting country," *Guardian*, November 25, 2002, http://www.guardian.co.uk/world/2002/nov/25/famine.argentina, accessed January 2012; and Sophie Arie, "Rural poor are victims as Argentina's crisis worsens," *Telegraph*, November 23, 2002, http://www.telegraph.co.uk/news/worldnews/southamerica/argentina/1414092/Rural-poor-are-victims-as-Argentinas-crisis-worsens.html, accessed January 2012.

[13] "Devaluation's downbeat start," *Economist*, January 11, 2002.

[14] "Fixing the rate, not the problem," *Economist*, January 11, 2002.

[15] "Variación de la Deuda Pública Bruta—Diciembre 2001/Junio 2005," Ministerio de Economía, www.mecon.gov.ar, accessed January 2012.

[16] Mario Vicens, "Argentina después del default: perspectivas económicas a mediano y largo plazo," XIX Seminario Nacional de Presupuesto Público, November 2005.

[17] "U.S. Department of State, 2005 Investment Climate Statement—Argentina."

[18] Dirección Nacional de Investigaciones y Análisis Fiscal, based on data from AFIP, ANSeS, Dirección Nacional de Coordinación Fiscal con las Provincias, Oficina Nacional de Presupuesto, and other organizations.

[19] "Adiós Menem, hallo Kirchner?" *Economist*, January 1, 2003.

[20] Daniel Kostzer, "Argentina: A Case Study on the *Plan Jefes y Jefas de Hogar Desocupados*, or the Employment Road to Economic Recovery," Levy Economics Institute of Bard College, Working Paper No. 534, May 2008, http://www.levyinstitute.org/pubs/wp_534.pdf, accessed January 2012.

[21] That is to say, workers' salaries were worth as much as 44.7% of the GDP in 1993. Silvia Stang, "La esquiva meta del fifty fifty: mitos y verdades de la distribución del ingreso," *La Nación*, January 27, 2013, http://www.lanacion.com.ar/1549178-la-

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esquiva-meta-del-fifty-fifty-mitos-y-verdades-de-la-distribucion-del-ingreso, accessed January 2013. The article cited data from Argentina's Dirección Nacional de Cuentas Nacionales for data from 1993 (44.7%) and 2003 (34.3%).

[22] "Reform not revolution," *Economist*, April 24, 2003; and Larry Rohter, "Argentina's Fallen Economic Czar Is Held in Arms Deal," *New York Times*, April 4, 2002.

[23] "The Talking Begins," *Economist,* August 9, 2003.

[24] Laurence Norman, "Argentina Wage Hike Opens Web of Unintended Consequences," Dow Jones Newswires, July 15, 2003, via Factiva.

[25] Laurence Norman, "Argentina Ups Minimum Wage, Pension in Move to Lift Econ," Dow Jones Newswires, July 11, 2003, via Factiva.

[26] "First Blows," *Economist,* July 5, 2003.

[27] Jon Jeter, "Argentina's Leader Charts New Course; Kirchner to Seek White House Backing," *Washington Post*, July 22, 2003, p. A19, via Lexis Nexis.

[28] Ibid.

[29] "Holders of Argentine Bonds Reject 25% Redemption Offer," *New York Times,* September 23, 2003.

[30] The primary budget surplus is the budget surplus before interest payments or debt amortization. That is, the primary surplus represents the amount of money that the government has available to make interest payments or pay down outstanding debt.

[31] Argentine Republic, *Exchange Offer*, January 12, 2005, www.argentinedebtinfo.gov.ar/documentos/argentina_roadshow_presentation_enero_12_2005_v_final_web, accessed January 2012.

[32] Martín Kanenguiser, "Duro fallo por la deuda contra el Gobierno, que ahora deberá ir a la Corte Suprema de EE.UU," *La Nación*, Buenos Aires, August 24, 2013.. /

[33] Data from the Ministry of the Economy's website, www.mecon.gov.ar/sip/dniaf/tributos_vigentes.pdf, accessed January 2012.

[34] Figures from INDEC, www.indec.mecon.ar, accessed January 2012.

[35] See David Hawkins, Gustavo Herrero, et al., "Aluar: Aluminio Argentino S.A.," HBS No. 111-059 (Boston: Harvard Business School Publishing, 2011) for further information on the impact of the lack of inflation accounting in Argentina.

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