Argentina's Long Adjustment - by Rohith Jyothish

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Argentina's recovery, again

Argentina has experienced repeated cycles of stabilisation followed by crisis. Inflation is brought down, fiscal order is restored, access to external finance resumes, and markets declare success. Yet these moments rarely translate into sustained growth, durable welfare provision, or institutional rebuilding. Instead, stabilisation is followed by renewed foreign-exchange pressure, social strain, and political fragmentation, culminating in another adjustment episode.

This recurrence is not well explained by claims of fiscal irresponsibility or policy incompetence. Argentina has repeatedly demonstrated the capacity to impose discipline when required. The more relevant question is **what kind of discipline is imposed, and what it achieves**. Across successive episodes, adjustment has been secured by compressing domestic demand, public employment, and welfare provision rather than expanding productive capacity or resolving external constraint that underlies Argentina's crises.

The question is this:

> **Why does austerity-led stabilisation continue to return as the dominant response to crisis in Argentina, even though it repeatedly fails to generate durable development?** And why does this strategy retain political legitimacy despite its social and institutional costs?

The answer lies in how adjustment is organised. Each crisis elevates a narrow objective—stopping inflation, defending the currency, regaining access to dollars—and subordinates everything else to it. Fiscal consolidation is achieved by cutting or postponing spending that is politically easier to compress like transfers to provinces, public employment, health and education budgets, infrastructure maintenance. These measures deliver quick, visible results in prices and financial indicators, which restores confidence and political support. But they do so by running down the state's ability to sustain growth, provide public goods, or reduce external dependence. Stabilisation works in the short run precisely because it shifts the costs onto institutions and households that absorb them quietly, setting the stage for the next crisis rather than resolving the underlying tone.

Discipline as a governing solution

The central role of discipline in Argentina's adjustment strategies was not simply a reaction to crisis. It was shaped by a set of economic ideas that became dominant from the late 1980s onward, especially within international financial institutions and policy circles. In this view, inflation was seen less as a symptom of deeper economic problems and more as a failure of commitment. The core concern was whether governments could credibly convince markets that they would restrain themselves.

Within this framework, inflation was treated as a **credibility problem** *(the belief that governments cannot be trusted to maintain price stability without binding constraints)*. Elected governments were assumed to face constant pressure to delay painful decisions, accommodate wage and price conflicts, and spend more than revenues allowed. Left to their own discretion, the argument went, they would repeatedly choose short-term political relief over long-term stability producing what economists described as an **inflation bias** *(a tendency toward persistently higher inflation)*.

The proposed solution was not better judgement or stronger state capacity, but rules that limited choice. Stability was to be achieved by narrowing what governments could do. Fixed exchange rates, fiscal ceilings, independent central banks, and externally monitored adjustment programmes were designed to remove key economic decisions from day-to-day politics. In this approach, credibility did not come from outcomes like growth or employment, but from adherence to pre-committed rules. Economic stability was secured by constraining democratic policy space rather than expanding it.

Argentina's convertibility regime of the 1990s represented an unusually hard application of this logic. The law required the central bank to hold US dollars for every peso it issued, preventing the government from expanding the money supply or adjusting the exchange rate. In practice, this meant that economic shocks could not be absorbed through policy. They had to be absorbed through spending cuts, wage compression, or unemployment. After years of hyperinflation, the arrangement initially delivered price stability and attracted foreign capital. At the time, this was widely taken as evidence that binding the state to an external rule was the surest way to impose discipline.

What this framework obscured was how stability was being produced. As the peso became overvalued, domestic industry weakened, imports surged, and growth increasingly depended on continued capital inflows. Argentina’s long-standing **external constraint** (*the chronic shortage of foreign exchange needed to sustain growth*) tightened rather than eased. When global financial conditions shifted in the late 1990s, government finances deteriorated not because of expanding welfare spending, but because revenues collapsed and interest payments rose in a stagnating economy. Adjustment, when it came, took the form of further cuts to defend the rule, rather than measures aimed at rebuilding productive capacity.

The collapse of convertibility in 2001—when Argentina was forced to abandon the dollar peg after years of recession, capital flight, banking freeze and mass protests—exposed the limits of this strategy, but it did not dislodge the underlying ideas. Instead, the dominant interpretation among creditors was that discipline had been unevenly applied or politically compromised.

Source: https://peoplesdispatch.org/2024/12/20/the-argentinazo-23-years-since-the-massive-anti-neoliberal-protests-in-argentina/

Subsequent IMF engagements reframed adjustment around surplus targets, subsidy withdrawal, and institutional reforms designed to reassert commitment, with financing released in stages only if governments met agreed fiscal and policy targets. The exchange-rate peg was gone. But the logic remained the same. Stability meant convincing markets that economic policy would stay constrained.

This intellectual legacy helps explain why austerity repeatedly reappears as the default response to crisis. These politics persist not only because alternatives are difficult to implement, but because they are embedded in a framework that treats inflation control and fiscal restraint as prerequisites for any other economic goal. Development, employment, and welfare are assumed to follow once credibility is restored. Argentina's history suggests that the sequence often runs in the opposite direction—but the ideas governing adjustment have proved remarkably durable.

The exception: recovery after default

Argentina's fastest and most sustained recovery did not occur under a regime of strict external discipline, but after its suspension. Following the collapse of convertibility in 2001, Argentina defaulted on its external debt, imposed capital controls, and allowed the peso to depreciate sharply. These measures were not part of a carefully designed alternative model; they were emergency responses to economic and political breakdown. Yet they produced a recovery that unsettled the prevailing logic of adjustment.

Between 2002 and 2007, growth averaged above 8 percent a year. Employment recovered rapidly, poverty fell sharply from crisis peaks, and public revenues improved despite the absence of orthodox fiscal restraint. This recovery was driven by a competitive exchange rate that supported exports & domestic industry, capital controls that reduced financial volatility, and a deliberate shift in policy priorities toward restoring demand and state capacity rather than reassuring creditors.

Crucially, this period relaxed the external constraint rather than attempting to discipline it away. Export growth generated foreign exchange, while capital controls limited outflows. The state regained room to finance public spending, rebuild institutions, and renegotiate debt on terms that reflected domestic recovery rather than immediate market approval. Debt restructuring in 2005 and 2010 imposed significant losses on private creditors, reducing the burden of external payments and weakening the hold of financial markets over fiscal policy.

This episode wasn't exactly a permanent or perfect alternative. But it reversed the assumed sequence of adjustment. Growth came before "credibility" was established. Stability was built through expanding productive activity and employment, rather than compressing demand. Inflation did rise, and institutional weaknesses persisted, but the recovery demonstrated that external discipline was not a prerequisite for economic normalisation.

The exception did not last. As commodity prices softened, capital pressures returned, and political coalitions shifted. Argentina gradually re-entered global financial markets. with that return came renewed emphasis on credibility, surplus targets, and policy restraint. The recovery after default was reinterpreted not as evidence of a different path, but as a temporary deviation made possible by unusually favourable conditions.

Yet the significance of this period lies precisely in what it revealed. Argentina's problem was not an inability to grow or govern without external discipline. It was difficulty of sustaining that autonomy once access to international finance became the overriding objective again. The post-default recovery showed that the constraints shaping Argentina's adjustment were not purely economic, but political and institutional—embedded in how stability itself had come to be defined.

From exception to rule again

The 2018 IMF programme under President Mauricio Macri formalised the return to the earlier policy regime. Framed as a technical stabilisation effort, it relied on fiscal contraction, subsidy withdrawal, and capital account openness to restore investor confidence. The programme collapsed under the weight of capital flight and recession, but its failure did not discredit the governing logic. Instead, it reinforced the belief that adjustment had been politically interrupted rather than economically misdirected.

This interpretation paved the way for Javier Milei. His programme did not represent a sharp break from Argentina's recent adjustment history, but its radicalisation. Milei removed the remaining ambiguities from fiscal policy by treating austerity not as a temporary correction, but as a governing principle. Inflation control, budget balance, and market access were elevated above all other policy objectives. Where earlier governments treated adjustment as a painful necessity, Milei reframed it as a moral virtue.

The political success of this approach rested on two factors. First, the immediate decline in inflation delivered visible relief after years of price instability. Second, austerity was presented not as a trade-off, but as a cleansing act that would finally restore economic normalcy. The costs—falling real wages, eroded public services, and weakened state capacity—were framed as transitional sacrifices rather than structural outcomes.

Yet this strategy reproduces the same vulnerability that has defined earlier cycles. Stabilisation is achieved by compressing domestic demand and public provision rather than by expanding foreign-exchange earning capacity or rebuilding institutions. External dependence remains intact. Growth remains fragile. The economy becomes more stable on paper while more brittle in practice.

What distinguishes the present moment is not the novelty of the policy tools, but the narrowing of the political imagination. Alternatives demonstrated in Argentina's own recent history—capital controls, debt restructuring, demand-led recovery—are treated as aberrations rather than options. Stability is no longer debated as a means to development, but accepted as an end in itself.

Why the cycle persists

Argentina's repeated return to austerity cannot just be explained by ignorance, external coercion, or failure to learn. The persistence of this model lies in how adjustment redistributes economic risk and political responsibility.

Austerity-led stabilisation shifts the burden of crisis away from financial markets and onto domestic institutions. Inflation is controlled, debt service is prioritised, and access to external finance is restored. The costs of this stabilitsation are dispersed across households and local governments, where they are harder to attribute to specific decisions. The stability is visible, but the erosion of state capacity is diffused.

This asymmetry gives austerity a political advantage. Market approval is immediate and legible. Inflation numbers move quickly. Exchange rates stabilise. By contrast, the benefits of alternative strategies—industrial rebuilding, export diversification, institutional repair—take time, require coordination, and generate conflict. In an economy repeatedly exposed to external pressure, governments are rewarded for short-term stabilisation even when it undermines long-term capacity.

This helps explain why figures like Javier Milei can succeed politically without breaking from Argentina's adjustment tradition. His programme does not resolve the external constraint; it manages it more aggressively. By treating fiscal balance as a moral imperative rather than a temporary instrument, austerity is reframed as responsibility itself. The promise is not development, but order.

The post-default recovery showed that a different sequence is possible: growth before credibility, capacity before compliance. But it also revealed why that sequence is difficult to sustain. Once access to international finance is restored, the benchmarks of success shift back to fiscal ratios and price stability. Autonomy becomes conditional, and policy space narrows again.

Argentina's long adjustment is therefore not a failure of discipline, but a failure of what discipline has been applied to. Budgets and wages have been repeatedly compressed while the external constraint remains intact. Until adjustment is redirected toward expanding foreign-exchange earning capacity and rebuilding state institutions, stabilisation will continue to succeed on paper while reproducing the conditions for its own return.

Further Reading: ideas, debates, and histories behind Argentina's long adjustment

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This essay draws on several overlapping strands of economic and political economy research. The readings below are grouped by theme and briefly explained for readers who want to go deeper.

1. Credibility, discipline, and the case for rules

These works shaped the intellectual case for constraining governments through fixed rules, which informed exchange-rate pegs, fiscal ceilings, and IMF conditionality.

- **Kydland, Finn & Edward Prescott (1977)** – *Rules Rather Than Discretion*

  Introduces the idea of *time inconsistency*: governments may promise stability but face incentives to deviate later, justifying binding rules.

- **Barro, Robert & David Gordon (1983)** – *Rules, Discretion and Reputation in a Model of Monetary Policy*

  Formalises the concept of *inflation bias* and frames credibility as the central problem of macroeconomic policy.

- **IMF Staff Reports and Article IV Consultations on Argentina (1990s–2010s)**

  Show how these ideas were operationalised through surplus targets, subsidy cuts, and phased disbursements.

2. Convertibility, crisis, and the limits of external discipline

These works analyse Argentina's 1991–2001 currency peg and explain why credibility-based stabilisation collapsed.

- **Damill, Frenkel & Rapetti (2005)** – *The Argentinean Debt: History, Default and Restructuring*

  A structural account of how fixed exchange rates and capital openness tightened the external constraint and produced crisis.

- **Jayati Ghosh (2016)** – *Argentina: A Cautionary Tale from South America*

  Places convertibility within a broader critique of financial liberalisation and its distributive consequences.

- **Cibils, Weisbrot & Kar (2002)** – *Argentina Since Default: The IMF and the Depression*

  Challenges the IMF's fiscal-profligacy narrative and shows how austerity deepened the downturn before default.

3. The external constraint and structuralist political economy

These works explain why growth in economies like Argentina is limited by access to foreign exchange rather than fiscal effort alone.

- **Raúl Prebisch (various)** – Structuralist writings on centre–periphery trade and foreign-exchange scarcity

  Foundational to understanding why import dependence constrains development.

- **Frenkel & Rapetti (2009, 2011)** – On real exchange rates, capital flows, and development

  Show how exchange-rate regimes shape growth paths in middle-income economies.

- **Alejandro Vanoli (2018)** – *Managing Monetary Policy and Financial Supervision in Argentina*

  A practitioner's account of monetary sovereignty, capital controls, and political conflict over external constraint.

4. Post-default recovery and debt restructuring

These readings analyse Argentina's 2002–07 recovery as an empirical challenge to credibility-first adjustment.

- **C.P. Chandrasekhar & Jayati Ghosh (2017)** – *The Argentina Debt Saga*

  Explains debt restructuring, holdout litigation, and the absence of a sovereign bankruptcy framework.

- **IMF Independent Evaluation Office reports on Argentina**

  Document internal disagreements and retrospective reassessments of IMF strategy.

5. Political economy of adjustment and persistence

These works help explain *why* austerity persists politically even when its economic record is mixed.

- **Dani Rodrik (2008)** – *The Globalisation Paradox*

  Frames the tension between democracy, national policy autonomy, and global capital mobility.

- **Carlos Gervasoni (2024)** – *Argentina: Milei's Successful and Unsettling First Year*

  Analyses Milei's political strategy, delegative leadership, and the appeal of inflation control.

- **C.P. Chandrasekhar (Frontline, various)**

  On "dollar democracy" and the geopolitical dimensions of financial support.