



Initiative for Policy Dialogue



El Consenso de Buenos Aires

*Una Nueva Agenda para America Latina
Quince Años Después del Consenso de Washington*

Buenos Aires, 23 de Agosto de 2005

CRISIS AND RECOVERY: LESSONS FROM ARGENTINA'S EXPERIENCE

Buenos Aires
2005

Joseph E. Stiglitz
The Initiative for Policy Dialogue
Columbia University, New York

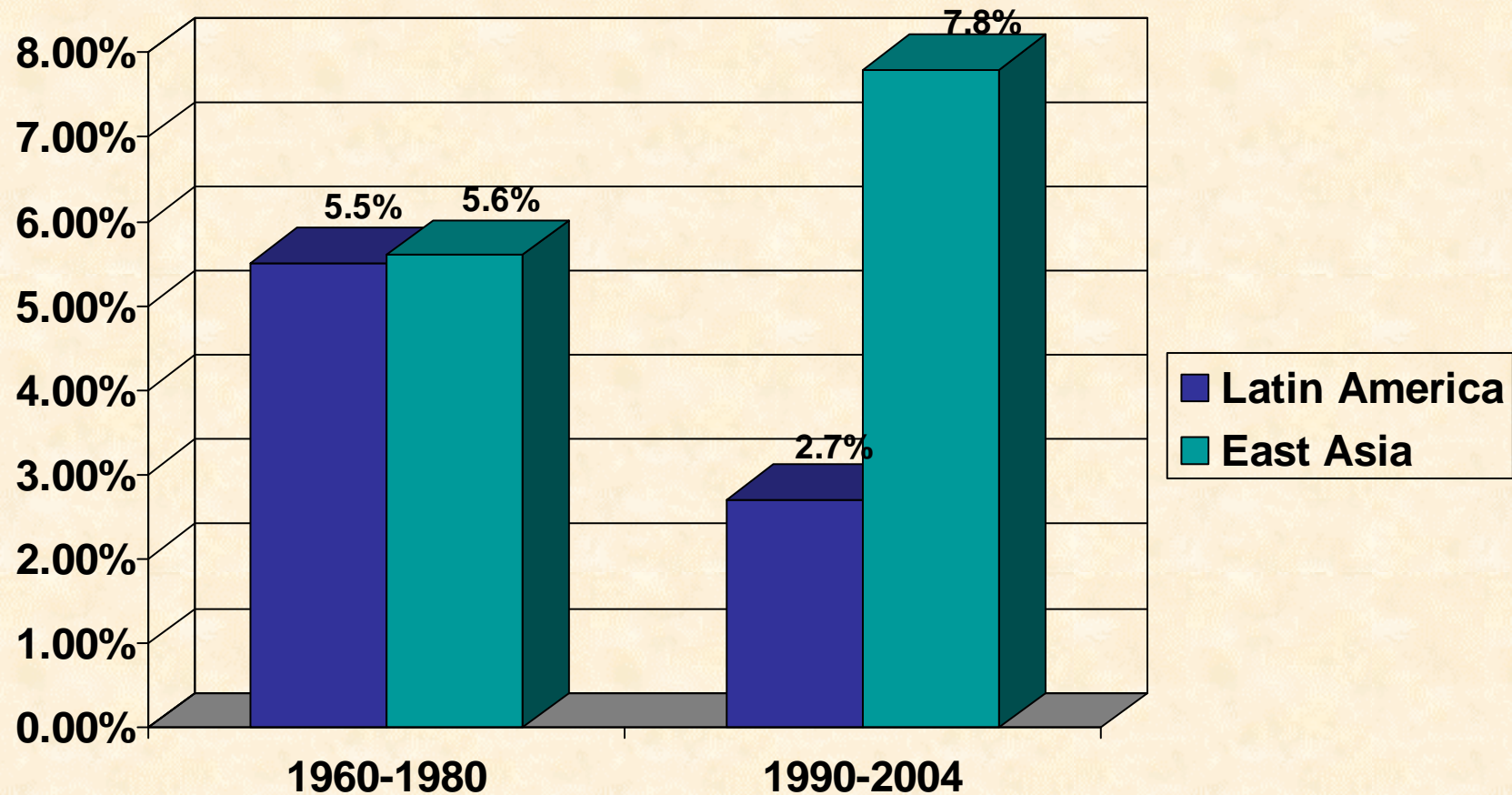
THE FAILURE OF THE WASHINGTON CONSENSUS: THEORY AND PRACTICE

- Based on market fundamentalism
 - Modern economics- including the economics of information- explains the pervasiveness of market failures, limitations of markets
 - Especially relevant to developing countries
 - Imperfect information
 - Imperfect markets
 - Importance of innovation and change
 - Conventional theory ignores technical change!
 - Even with well functioning markets, markets may not lead to results consistent with social justice
 - Two approaches:
 - Neoclassical paradigm argued equity and efficiency could be separated
 - Trickle down economics
 - » **Both wrong in theory and in practice!**

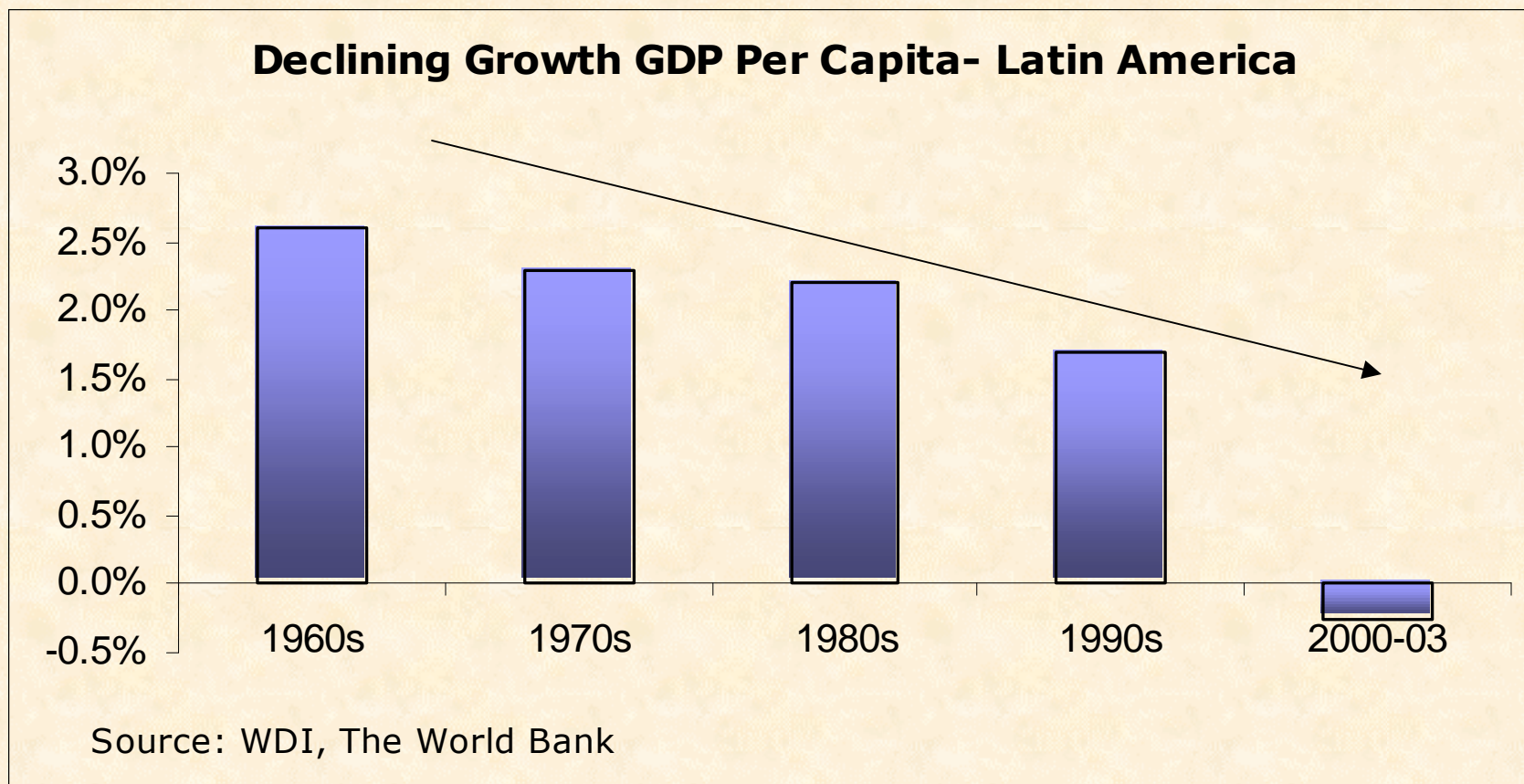
CONCEPTION

- Too narrow in objectives
 - Maximize GDP
 - Country could be getting poorer even as GDP increased
 - Environmental degradation
 - Resource depletion
 - Increasing liabilities
 - More foreign ownership
 - Rich countries with poor people
 - Median income may be a better measure of success
- Confused means with ends- privatization, liberalization
- No attention to equity
 - Equity is an end in its own right
 - But without minimal equity, there can't be social and political stability
 - And without social and political stability, private investment can't be attracted- there won't be growth
 - Without equity, human resource, countries most important asset, won't be fully utilized
- Too narrow a set of instruments

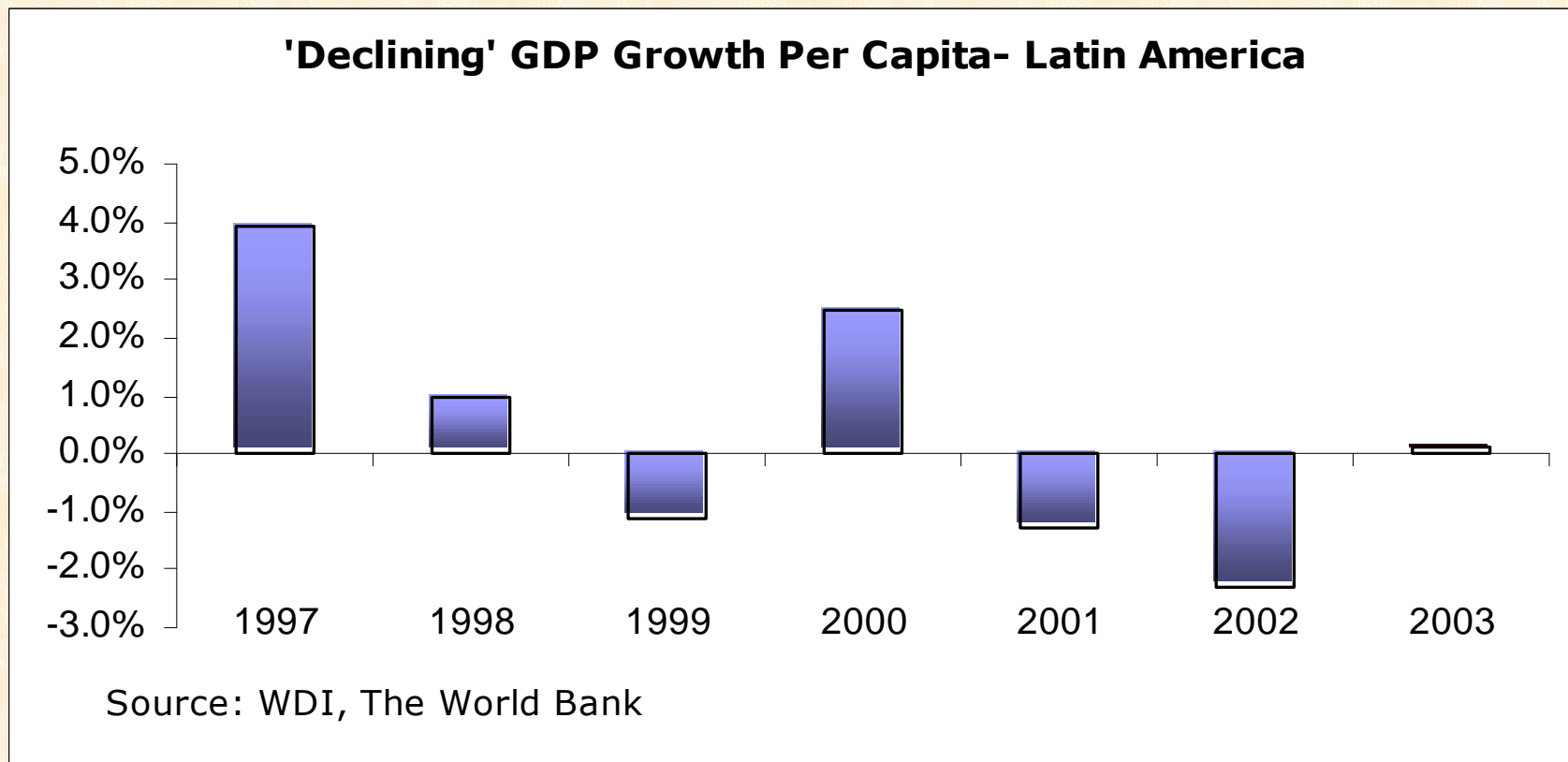
ECONOMIC GROWTH: LATIN AMERICA AND EAST ASIA



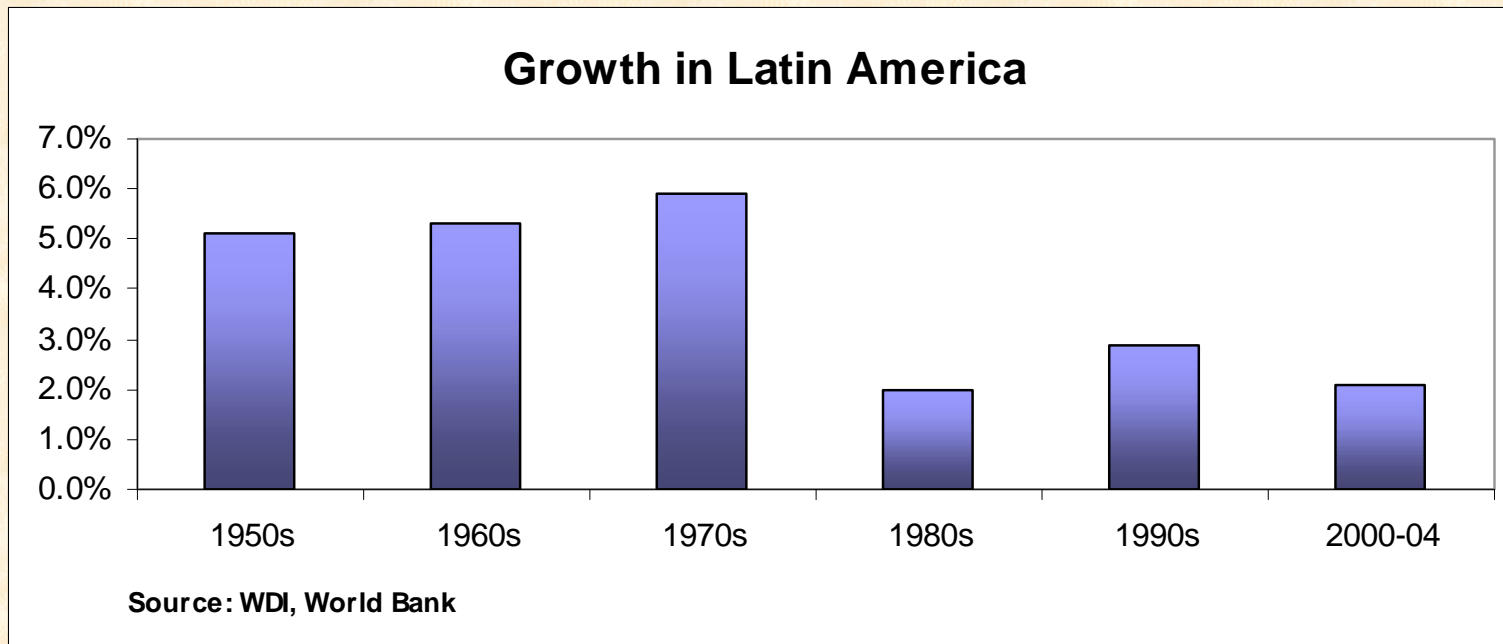
DECLINING GROWTH IN PER CAPITA INCOME IN LATIN AMERICA



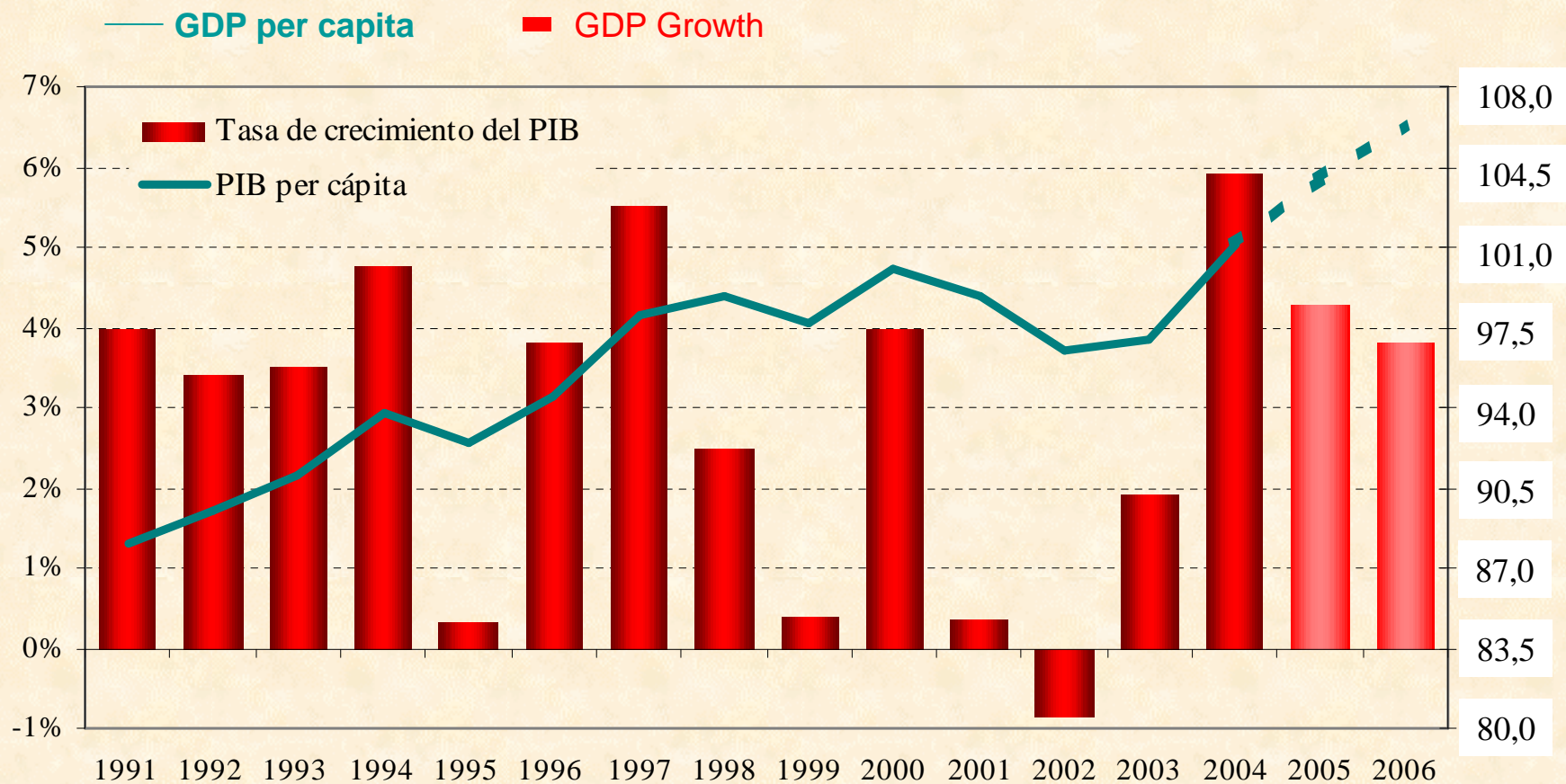
MORE RECENTLY, ACTUALLY DECLINING IN SOME YEARS AND VOLATILE



LATIN AMERICA ALSO EXPERIENCED TREMENDOUS VOLATILITY OF GROWTH



Latin American GDP per capita growth

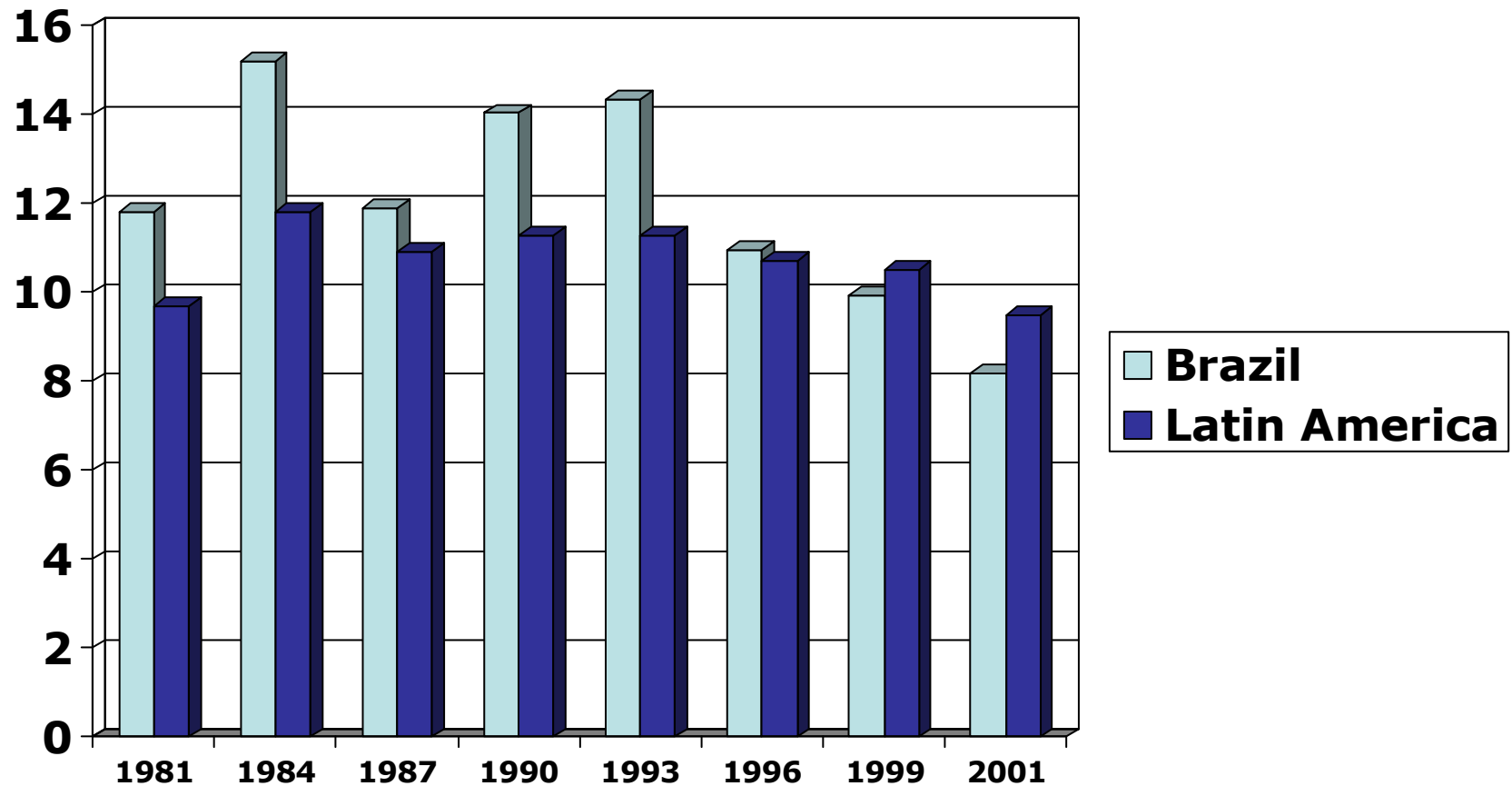


Source: Eclac, 2005 and 2006 projections

IN PRACTICE

- Failed to produce growth
- Even when there was growth, a disproportionate share went to upper income
- Growing unemployment, *even after labor market liberalization*
- Growth of informal sector, without job protection

POVERTY RATES IN LATIN AMERICA: 1980-2003



... AND UNEMPLOYMENT HAS BEEN RISING IN LATIN AMERICA



Source: ECLAC

ARGENTINA'S EXPERIENCE- SOCIAL SECURITY PRIVATIZATION AS A CASE STUDY

- In US- overwhelming opposition as:
 - Understanding that deficit will increase
 - Private sector less efficient than public (higher transaction costs)
 - Will not solve underlying solvency issues
 - Will not solve future bail-out issues
 - Will lead to marked increase in poverty in aged
- In Argentina-
 - Budget deficit led to tighter fiscal policy
 - Failed understanding of accounting frameworks by IMF
 - Tighter fiscal policy led to lower income
 - Lower incomes worsened budgetary position- vicious circle
 - Significant fraction of budget deficit due to social security privatization

EIGHT LESSONS

1. Overvalued exchange rates stifle growth
 - Growth after exchange rate came down
2. Borrowing to finance consumption binge does not lead to sustained growth
 - Standard accounting frameworks provide poor guidance on how well economy is doing
 - Capital markets short-sighted
 - IMF “seal of approval” can be dangerous
 - IMF, capital market diagnosis can be unreliable
 - IMF paraded President Menem at annual meeting as paragon of virtue, of model for others to follow
 - Argentina became the largest recipient of funds

EIGHT LESSONS

3. Keynes was right- contractionary monetary and fiscal policies are contractionary

- "Hoover"-IMF recipe, reduce deficit as a way of winning confidence, restoring economy does not work
- It has never worked and is not based on economic science
- This view may serve special interests

4. Markets are forward looking

- Growth, not the IMF, begets confidence
- Argentina was right to take its own course
- Proved successful
- Following the IMF would have been a disaster- contractionary policies would have inhibited growth

EIGHT LESSONS

5. IMF money would have stayed in Washington- not helped recovery
 - Failure to understand role of finance
 - Parallels misunderstanding of the role of short term capital- cannot build factories with money that can come in and out of the country overnight
 - What matters is finance to firms and terms at which money is available
 - This policy needed to be encouraged
 - Tight monetary policies discourage lending
 - Basic stance was correct- seek a “good” IMF program; no program better than a bad program

EIGHT LESSONS

6. Tough bargaining made sense

- Affects future liability
- IMF/creditors consistently overly optimistic
- But insufficient restructuring simply postpones problems, keeps noose around neck
- Uncertainty about future prospects
 - Market failure- risk should be borne by rich countries
 - GDP bonds make sense
 - Sharing risk
 - Aligning incentives
- IMF showed that it represented creditor interests
 - Not surprising- predicted by political economy
 - Consistent with other stances

EIGHT LESSONS

7. Argentina shows values of a sovereign bankruptcy mechanism
 - Modeled on Chapter 9
 - Rapid restructuring
 - Collective action clauses will not suffice
 - IMF is not impartial- need alternative
8. Argentine experience likely to have enormous influence on thinking about exchange rate systems, macro-management, privatization strategies, accounting frameworks, debt management, crisis management, recovery strategies, dealing with IMF, etc
 - But small, less confident countries may not be able or willing to take stances consistent with these lessons
 - Emphasizes need to reform global institutions
 - And call for Argentina to take a leading role