

The Argentine Success Story and its Implications

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Executive Summary

The Argentine economy has grown 94 percent for the years 2002-2011, using International Monetary Fund (IMF) projections for the end of this year. This is the fastest growth in the Western Hemisphere for this period, and among the highest growth rates in the world. It also compares favorably to neighboring economies that are commonly seen as quite successful, such as Brazil, which has had less than half as much growth over the same period.

Argentina was trapped in a severe recession from mid-1998 to the end of 2001. Attempts to stabilize the economy and maintain the currency peg to the U.S. dollar, through monetary and fiscal tightening, led by the IMF and backed by tens of billions of dollars in lending, failed to arrest the economy's downward spiral.

In December of 2001, the government defaulted on its debt, and a few weeks later it abandoned the currency peg to the dollar. The default and devaluation contributed to a severe financial crisis and a sharp economic contraction, with GDP shrinking by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008-2009. The economy then rebounded, and the IMF now projects growth of 8 percent for 2011.

Argentina's real GDP reached its pre-recession level after three years of growth, in the first quarter of 2005. Looking at twenty-year trend growth, it reached its trend GDP in the first quarter of 2007.

The country experienced this remarkable economic growth despite the default and difficulties borrowing from international financial markets over the past nine years, and relatively little Foreign Direct Investment (FDI). This should give pause to those who argue, as is quite common in the business press, that pursuing policies that please bond markets and international investors, as well as attracting FDI should be the most important policy priorities for any developing country government.

Argentina's rapid growth has often been dismissed as a "commodity boom" driven by high prices for its agricultural exports such as soybeans, but the data show that this is not true.

Poverty has fallen by over two-thirds from its peak, from almost half of the population in 2001 to approximately one-seventh of the population in early 2010. Extreme poverty has fallen by about the same rate, from over one-fourth of the population in 2001 to approximately one in fifteen.

Income inequality has also fallen dramatically. In 2001, those in the 95th percentile had 32 times the income of those in the 5th percentile. By early 2010, this fell by nearly half, to 17. Perhaps more importantly, this change is due in large part to improving incomes among the poor and not just diminishing incomes among the rich.

Unemployment has fallen by over half from its peak, to 8.0 percent. And employment, by early 2010, had risen to 55.7 percent, the highest on record.

Social spending nearly tripled in real terms, and rose from 10.3 to 14.2 percent of GDP. In 2009, the government expanded the reach of its social programs, launching the "Universal Allocation per

Child” (*Asignación Universal por Hijo*) with the goal of reducing poverty and improving the welfare of children. This was a conditional cash transfer program for low-income households, similar to Brazil’s *Bolsa Familia* and Mexico’s *Progresar-Oportunidades* programs, which have won widespread international praise, but is significantly larger relative to GDP.

There were also significant reductions in infant and child mortality over the last nine years, somewhat more than in similarly situated countries.

Inflation has risen sharply since 2007, peaking most recently at 27 percent at the beginning of 2011 – according to non-official sources -- before beginning to decline somewhat again. This is a problem for the economy, but it is real income growth, employment, and income distribution that matter with regard to the well-being of the vast majority of the population. By these measures, as we have seen above, the government appears to have made the correct decision not to fight inflation by sacrificing economic growth. To take one important historical example, South Korea registered annual rates of inflation similar to those of Argentina in recent years, in the 1970s and early 80s, while it traversed the journey from a poor to a high income country.

However, inflation at this level can affect growth and employment through the exchange rate. If the nominal exchange rate is fixed or does not depreciate sufficiently in response to the inflation, then the domestic currency becomes increasingly overvalued in real terms. The peso has appreciated about 20 percent in real terms since 2007.

It is remarkable that Argentina has achieved its success in the face of adverse external circumstances, some of which continue to this day. Just one month ago the Obama administration, under pressure from “vulture funds” and their associated lobby groups, announced that it would oppose multilateral loans to Argentina.

Argentina’s success has important implications for Europe, including the weaker eurozone economies.

Greece, which has been pursuing policies similar to those adopted by Argentina during its 1998-2002 recession, is expected to need more than 9 years to reach its pre-crisis level of GDP. Unemployment, which is currently at 16 percent, could take even longer to reach normal levels. Trend level GDP is nowhere in sight.

The situation of the other weaker eurozone economies is similarly bleak. The attempt to adjust through “internal devaluation” in Europe is proving to be as much a disaster there as it was for Argentina in its deep 1998-2002 recession.

From the point of view of any of the individual governments that are being subjected to this process, the Argentine solution involving a default large enough to reduce the country’s debt burden to a manageable level would have to be considered as a possible alternative. For Greece at this point, for example, this could very possibly be preferable to its current trajectory, even if it were to involve leaving the euro.

Argentina’s experience also calls into question the popular myth that recessions caused by financial crises must involve a slow and painful recovery. Argentina’s financial crisis and collapse were as severe as that of almost any country in recent decades; and yet it took only one quarter after the

default to embark on a rapid and sustained recovery. This is not only because of the devaluation and improved macroeconomic policies, but because the default freed the country from having to be continually hamstrung by a crippling debt burden and by pro-cyclical policies imposed by creditors. The Argentine government has shown that Europe's bleak current situation and projected scenario is just one possible outcome, and that a rapid recovery in output, employment, poverty reduction, and reduced inequality is another very feasible path that can be chosen.

Introduction

It is striking that Argentina's economic growth over the last nine years has been given so little positive attention. China's success as the fastest-growing economy in world history has been widely recognized, even if the Chinese government is often criticized in the Western press for its trade and currency policies. India's rapid growth since 2003 (averaging 8.9 percent annually from 2003-2008) has also attracted much praise. But Argentina has not generally been seen as successful. Much of the press reporting has been negative, focusing on the high inflation of recent years.

But it is real income that matters in terms of living standards, and the Argentine economy has grown 94 percent for the years 2002-2011, using IMF projections for the end of this year. This is the fastest growth in the Western Hemisphere for this period, and among the highest growth rates in the world. It also compares favorably to neighboring economies that are commonly seen as quite successful, such as Brazil, which has had less than half as much growth over the same period. It should therefore be of interest to policy-makers and economists.

As will be seen below, the Argentine story also has implications for macroeconomic policy in other countries, and particularly for countries such as Greece, and perhaps some of the other, weaker eurozone economies that are currently pursuing pro-cyclical policies in an attempt to reduce high and in some cases unsustainable debt burdens. Perhaps even more importantly, it has significant implications for a currently widely held view¹ that recovery from recessions caused by financial crises must necessarily take much longer than recovery from other types of recessions.

Argentina's deep recession from 1998-2002 was one of the very worst, in terms of lost output, of the past hundred years; and it was clearly caused by a financial crisis that culminated in a systemic financial collapse. Yet the recovery was very rapid.

This paper presents a brief overview of Argentina's recent economic performance.

Recession, Default and Recovery

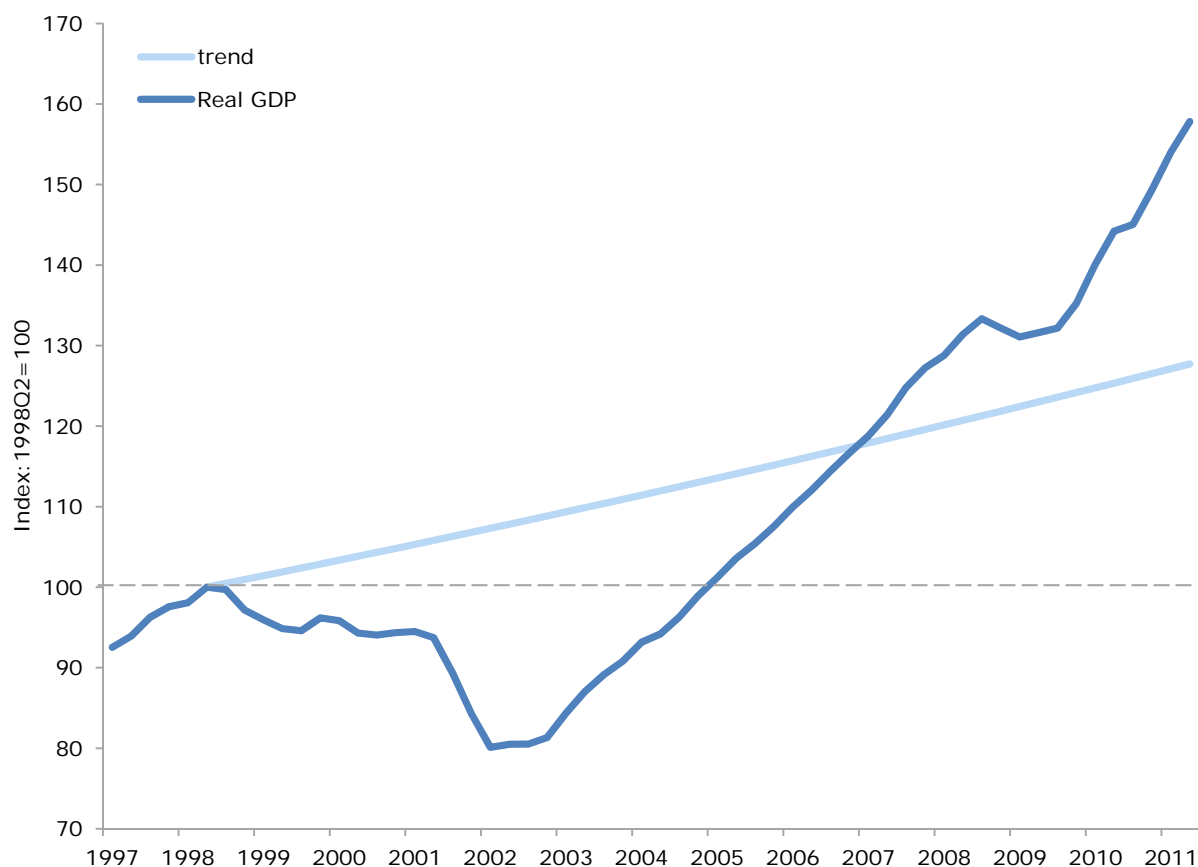
Argentina was trapped in a severe recession from mid-1998 to the end of 2001. Attempts to stabilize the economy and maintain the currency peg to the U.S. dollar, through monetary and fiscal tightening, led by the IMF and backed by tens of billions of dollars in lending, failed to arrest the economy's downward spiral.

¹ This view has been promoted most successfully by Reinhart and Rogoff (2009) and is widely accepted in the financial press.

In December of 2001, the government defaulted on its debt, and a few weeks later it abandoned the currency peg to the dollar. The default and devaluation contributed to a severe financial crisis and a sharp economic contraction, with GDP shrinking by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008-2009. The economy shrank by 0.9 percent in the fourth quarter of 2008, and by the same amount in the first quarter of 2009. But it rebounded quickly and grew by an annualized rate of 8.6 percent over the next 10 quarters (to the second quarter of 2011).² The IMF projects growth of 8 percent for 2011.

As can be seen from **Figure 1**, Argentina's real GDP reached its pre-recession level after three years of growth, in the first quarter of 2005. Looking at twenty-year trend growth, it reached its trend GDP in the first quarter of 2007.

FIGURE 1
Real GDP: Actual and 20-Year Trend (Seasonally-Adjusted)



Source: INDEC 2011a, IMF 2011b and Authors' Calculations.

² Non-government estimates of real GDP hold that the 2008-2009 recession was deeper, and the recovery slower, than what is suggested by official sources. See Frenkel (Forthcoming). However, the IMF notes that "the difference between private and official estimates of real GDP growth has narrowed in 2010."

It is worth noting that this recovery and growth was achieved without help from international lending institutions. In fact, the opposite took place: in 2002, the first year³ of the recovery, the IFF's (international financial institutions) took a net 4 percent of GDP out of the Argentine economy. The IMF also pressured the Argentine government to pay more to the defaulted external creditors; recommended tighter fiscal policy in order to achieve the goal of paying more to creditors; and opposed a number of other policies that were helpful to economic recovery and/or were designed to alleviate the burden of the crisis on distressed sectors of the population.⁴

As a result of the default, and the refusal of a minority of creditors to accept the eventual restructuring agreement in 2005, and subsequent legal action by these creditors and “vulture funds,” Argentina has faced difficulties borrowing in international financial markets over the last nine years. Since it has not been able to settle its debt with the government creditors of the Paris Club, it has also been denied some export credits. FDI has remained limited, averaging about 1.7 percent of GDP over the past eight years, with a number of serious legal actions taken by investors against the government.

Yet in spite of all of these adverse external conditions that Argentina faced during the past nine years, the country experienced this remarkable economic growth. This should give pause to those who argue, as is quite common in the business press, that pursuing policies that please bond markets and international investors, as well as attracting FDI, should be the most important policy priorities for any developing country government. While FDI can clearly play an important role in promoting growth through a variety of mechanisms, and foreign capital in general can, in some circumstances, boost growth by supplementing domestic savings, Argentina's success suggests that these capital inflows are not necessarily as essential as is commonly believed. And it also suggests that macroeconomic policy may be more important than is generally recognized.

Exports and Contributions to Growth

As noted above, Argentina reached its pre-recession level of GDP after three years of growth; so the rapid growth that has continued since 2005 cannot be attributed to a simple rebound from recession. (Although the initial recovery was by no means easy or assured, as can be seen by the slow recovery of many countries today from the 2008-2009 financial crisis and recession, as well as the history of Argentina's initial recovery.)⁵ Argentina's rapid growth has often been dismissed as a “commodity boom” driven by high prices for its agricultural exports such as soybeans, but this is not true.

Table 1 shows the real contributions to GDP growth by expenditure. It can be seen that the role of exports is not very large during the expansion of 2002-2008. It peaks at 1.8 percentage points of GDP in 2005 and 2010, and amounts to a cumulative 7.6 percentage points, or about 12 percent of the growth during the expansion. The story for net exports is even worse, with net exports (exports minus imports) showing a negative cumulative contribution over the period. The recovery is driven

³ The annual data show a decline of 11 percent in Argentine GDP for 2002. However, this is measured by taking the average GDP for 2002 and dividing by the average for 2001; as noted above, the Argentine economy actually started growing in the second quarter of 2002.

⁴ For more detail in the IMF's role during the recovery, see Weisbrot and Sandoval (2007).

⁵ See Weisbrot and Sandoval (2007) and Frenkel and Rapetti (2007) for more detail.

by consumption and investment (fixed capital formation), which account for 45.4 and 26.4 percentage points of growth, respectively.

TABLE 1
Argentina: Real GDP Growth, Contributions from Expense Categories (Percentage Points)

	Contributions from Each Expense Category						Total GDP Growth
	Private Consumption	Government Consumption	Gross Fixed Capital Formation	Exports	Imports	Change in Inventories and Stat. Discrep.	
1998	2.4	0.4	1.3	1.1	-1.1	-0.3	3.9
1999	-1.4	0.3	-2.7	-0.1	1.5	-1.1	-3.4
2000	-0.5	0.1	-1.3	0.3	0.0	0.6	-0.8
2001	-4.0	-0.3	-2.8	0.3	1.7	0.6	-4.4
2002	-9.9	-0.7	-5.8	0.4	5.6	-0.6	-10.9
2003	5.4	0.2	4.3	0.8	-2.4	0.5	8.8
2004	6.2	0.4	4.9	1.1	-3.2	-0.4	9.0
2005	5.9	0.8	4.0	1.8	-2.1	-1.3	9.2
2006	5.1	0.6	3.6	1.0	-1.7	-0.2	8.5
2007	5.9	0.9	2.9	1.3	-2.5	0.1	8.7
2008	4.3	0.8	2.1	0.2	-1.9	1.3	6.8
2009	0.3	0.9	-2.4	-0.9	2.7	0.2	0.9
2010	5.9	1.2	4.4	1.8	-3.9	-0.2	9.2

Source: INDEC (2011b).

However, this measure of real (inflation-adjusted) contributions to growth does not measure the full impact of exports when there are significant price increases for exports. In this case, if the price increase is large enough and the affected exports are a big enough share of the economy, the increased income can contribute to growth and to living standards (through the consumption of imports that do not add directly to GDP) in other ways, that do not show up in the real contributions to GDP growth measured above.

To consider these other effects of the rising value of exports, **Figures 2 and 3** show Argentina's annual exports by value, and by category; this is shown both in current dollars and below, in percent of GDP.

As can be seen in the graphs, exports as a percent of GDP, as measured by dollar value, actually decreased during the recovery. And agricultural exports, as a percent of GDP, fell slightly from 5.0 percent of GDP to 4.7 percent, dipping as low as 3.4 percent in 2006 – again, this is measured by dollar value, so it reflects the large increases in commodity prices from 2005 to 2008. So agricultural exports are clearly not driving growth; and in fact they are too small a share of GDP to have anywhere near the kind of impact that is often attributed to them.⁶

⁶ This is true even if we include some of the manufactured goods (e.g. soybean oil), which are linked to commodity prices. These are also shown in Figure 2. These are flat over the expansion in terms of dollar value as a percent of GDP.

FIGURE 2
Argentina: Export Value by Category and Value, in US Dollars

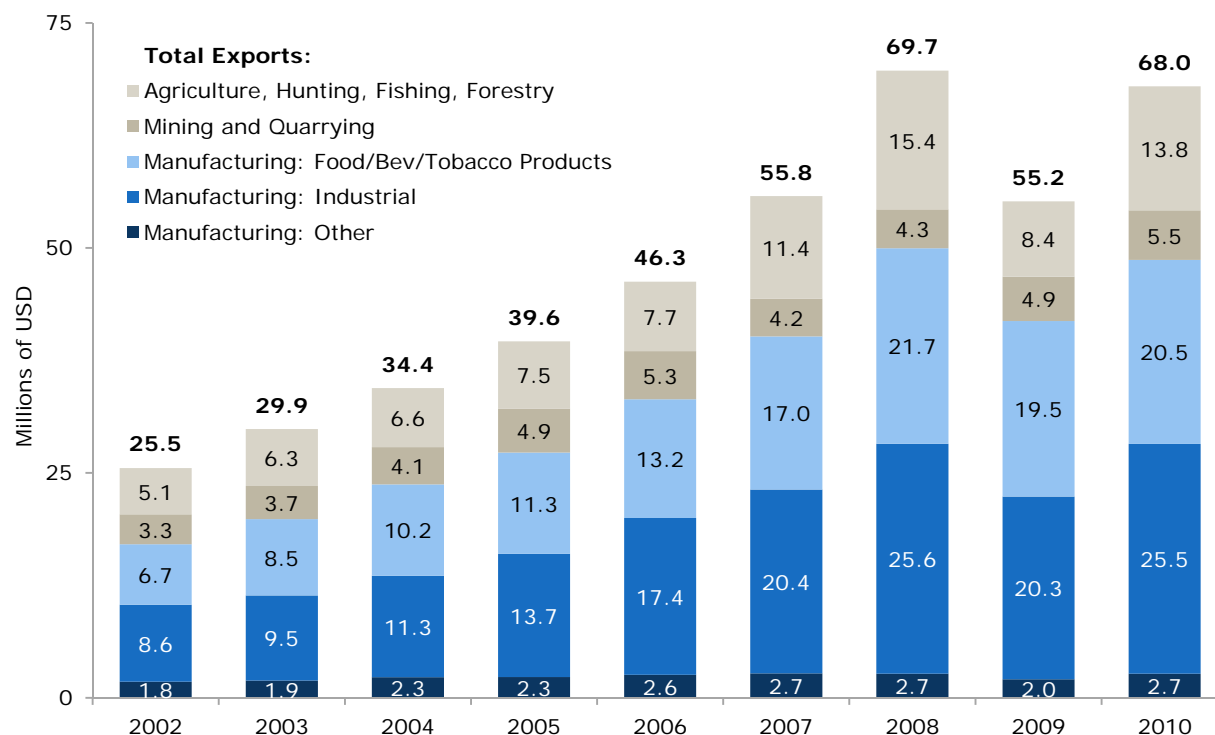
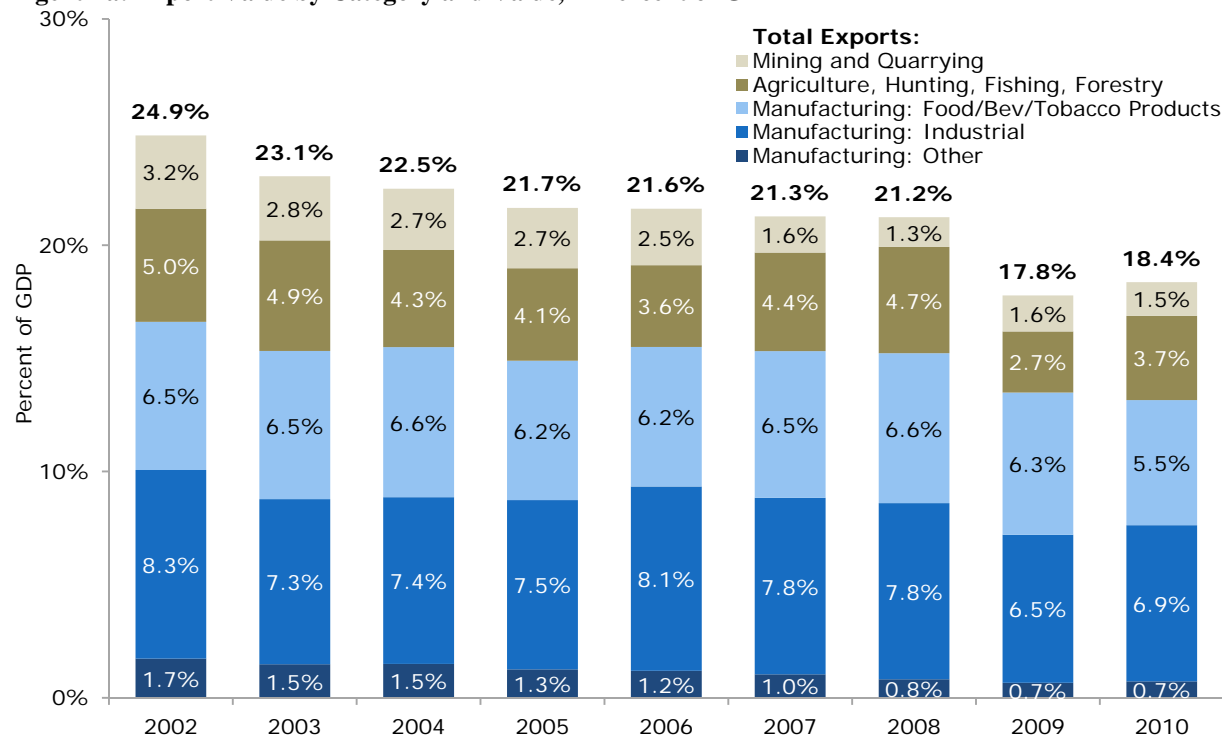


FIGURE 3
Argentina: Export Value by Category and Value, in Percent of GDP



Note: Other manufacturing includes textile, wood and paper products.

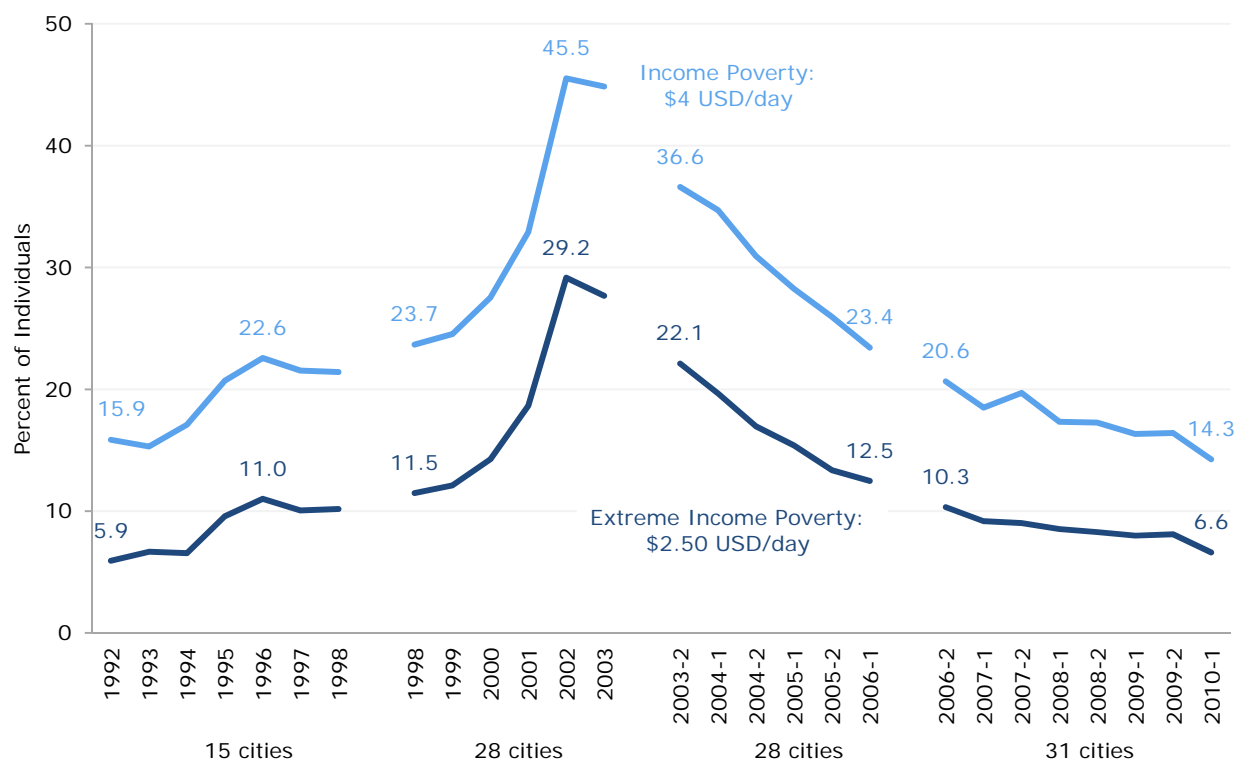
Source: CEPAL (2011).

Social Indicators

Poverty

As **Figure 4** shows, poverty has fallen by over two-thirds from its peak, from almost half of the population in 2001 to approximately one-seventh of the population in early 2010. Extreme poverty has fallen by about the same rate, from over one-fourth of the population in 2001 to approximately one in fifteen. In both cases, the rates have fallen to about their level in the early 1990s.⁷

FIGURE 4
Argentina: Poverty and Extreme Poverty, Percent of Individuals



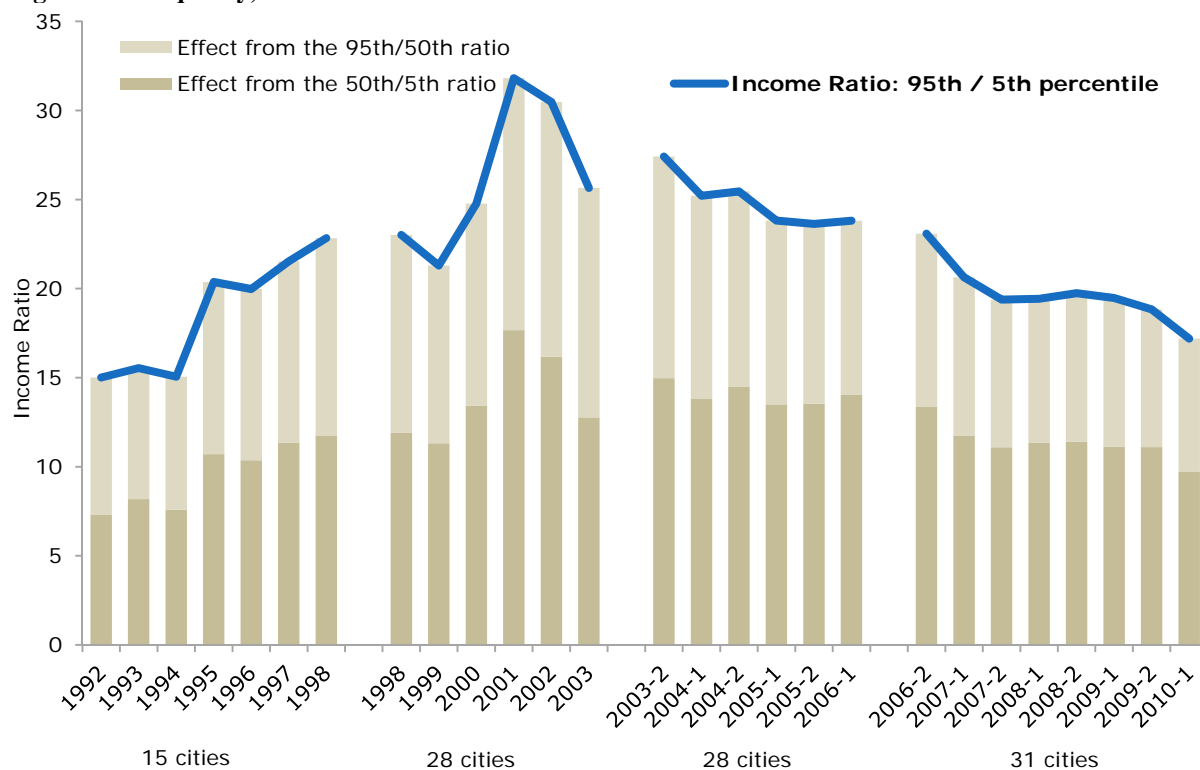
Source: CEDLAS and the World Bank (2011) and authors' calculations.

Income Inequality

As **Figure 5** shows, income inequality has also fallen dramatically. In 2001, those in the 95th percentile had 32 times the income of those in the 5th percentile. By early 2010, this fell by nearly half, to 17. Perhaps more importantly, this change is due in large part to improving incomes among the poor and not just diminishing incomes among the rich. As the tan bars show, since 2006 changes in the lower half of the income spectrum account for the majority of the improvement.

⁷ Figures 4 through 6 use the most recent data available, published through CEDLAS and the World Bank (2011).

FIGURE 5
Argentina: Inequality, Income Ratio of 95th Percentile to 5th Percentile



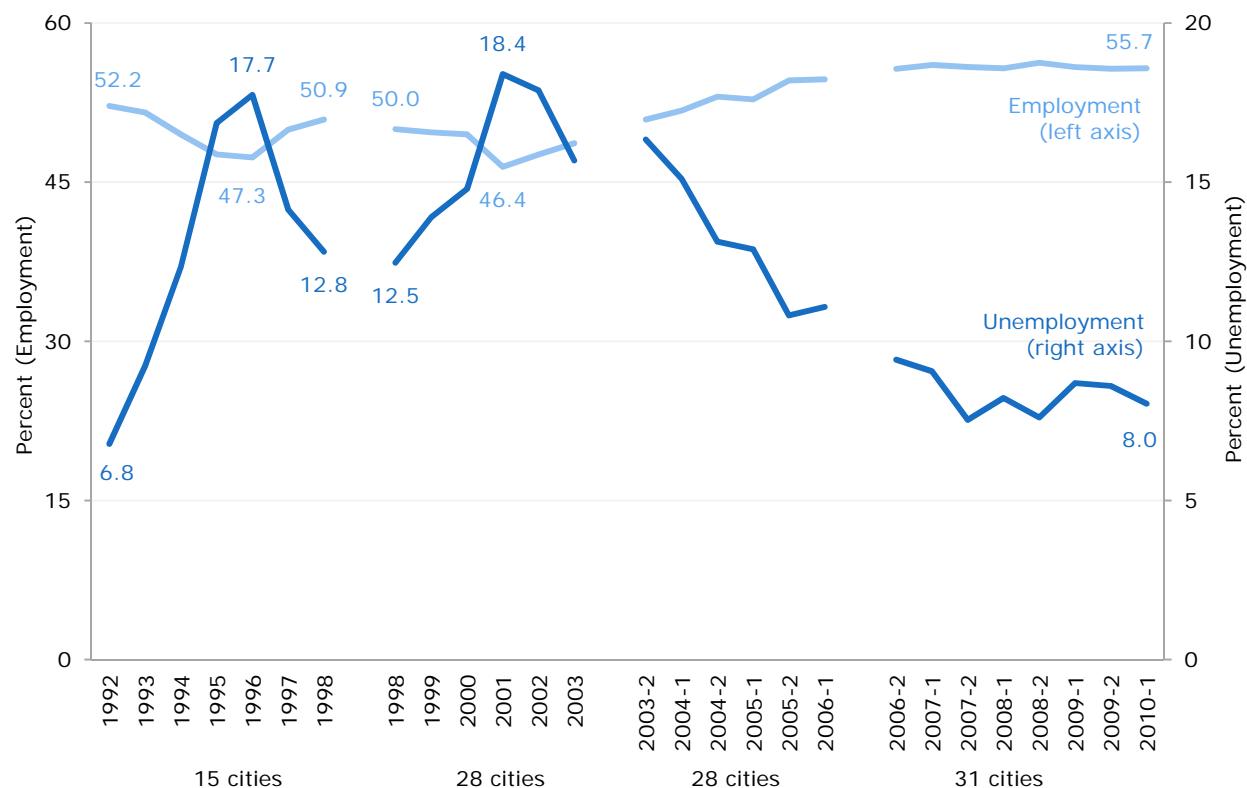
Source: CEDLAS and the World Bank (2011).

Labor Market

Whereas poverty had one clear, dramatic peak in 2002, the labor market saw two distinct years of difficulty: 1996 and 2001. As **Figure 6** shows, between 1992 and 1996, unemployment rose by over 150 percent, from 6.8 to 17.7 percent. It declined again to 12.5 percent in 1998, but within three years had risen to a record of 18.4 percent. Since then, it has fallen by over half, to 8.0 percent.

Employment showed a similar pattern, with the notable exception that its recent levels are even higher than its 1992 levels. Employment fell from 52 percent in 1992 to under half in 1997, briefly rose again to over 50 percent in 1998 and fell back to 46 percent in 2001. By early 2010, it had risen to 55.7 percent, the highest on record. This is not only because of women joining the labor force; men's employment is also above its 1992 level, at 87.7 percent.

FIGURE 6
Argentina: Employment and Unemployment



Source: CEDLAS and the World Bank (2011).

Social Spending and Conditional Cash Transfer Programs

The Argentine government presided over a huge increase in its social spending, as well as revenue, as a percent of GDP. Revenue increased from 15 percent of GDP in 2002 to 23.4 percent in 2009. Since the economy was growing rapidly through most of this time, this represents quite a large increase in revenue – it roughly tripled in real terms during this period. The vast bulk of this increase was not from the first few years of economic recovery but has occurred since 2005, after the economy had already reached its pre-recession level.

Spending on Social Security increased from 5.5 to 7.5 percent of GDP. The government also increased support to various sectors of the economy, from just 0.43 percent of GDP to 4.1 percent.

Like revenue, social spending nearly tripled in real terms, and rose from 10.3 to 14.2 percent of GDP. It began as a response to the deep recession and its lagged effects in 2002 and 2003. One program provided a monthly stipend (150 pesos) to heads of households who were unemployed with children of up to 18 years-old (or disabled of any age), and to those where the head of the household was ill. At its height in 2003, the program reached 20 percent of all households, with 97.6 percent of its beneficiaries under the poverty line.

In 2009, the government expanded the reach of its social programs, launching the “Universal Allocation per Child” (*Asignación Universal por Hijo*) with the goal of reducing poverty and improving the welfare of children. This was a conditional cash transfer program for low-income households, similar to Brazil’s *Bolsa Familia* and Mexico’s *Progres-a-Oportunidades* programs, which have won widespread international praise, but is significantly larger relative to GDP. Spending on the Universal Allocation per Child program has reached 0.6 percent of GDP in 2011, as compared with 0.4 percent of GDP for Mexico and Brazil.⁸ It is too early to say how much these programs have reduced poverty, but when the effect is measured it is almost certain to be quite large.

Health

Argentina’s health indicators have improved, not only over the past 9 years but also over the past 20 years; but to evaluate the recent progress, we need to compare it to the performance of similarly situated countries. To do that, the figures below compare Argentina’s 1990–2010 progress to that of other upper-middle income countries,⁹ starting at the year they reached Argentina’s 1990 level. In other words, these figures answer the question: what is normal progress for a country like Argentina, starting from where it was in 1990? We look at child and infant health here, as adult health depends on changes over a much longer period of time than the focus of this analysis.

Figure 7 shows progress in infant mortality, which has fallen by approximately half in Argentina since 1990, from 26.9 to 13.8 deaths per 1,000 live births. However, for the first decade after 1990, Argentina’s progress was significantly slower than that of its peers. By 2000, infant mortality was 14 percent higher in Argentina than in its peer countries: 17.5 compared to 15.3 deaths per 1,000 live births. Beginning in 2001, Argentina began slowly closing this performance gap, and by 2010 it had essentially eliminated it, shrinking it to 0.6 deaths per 1000 live births, about the same as it was in 1990.¹⁰

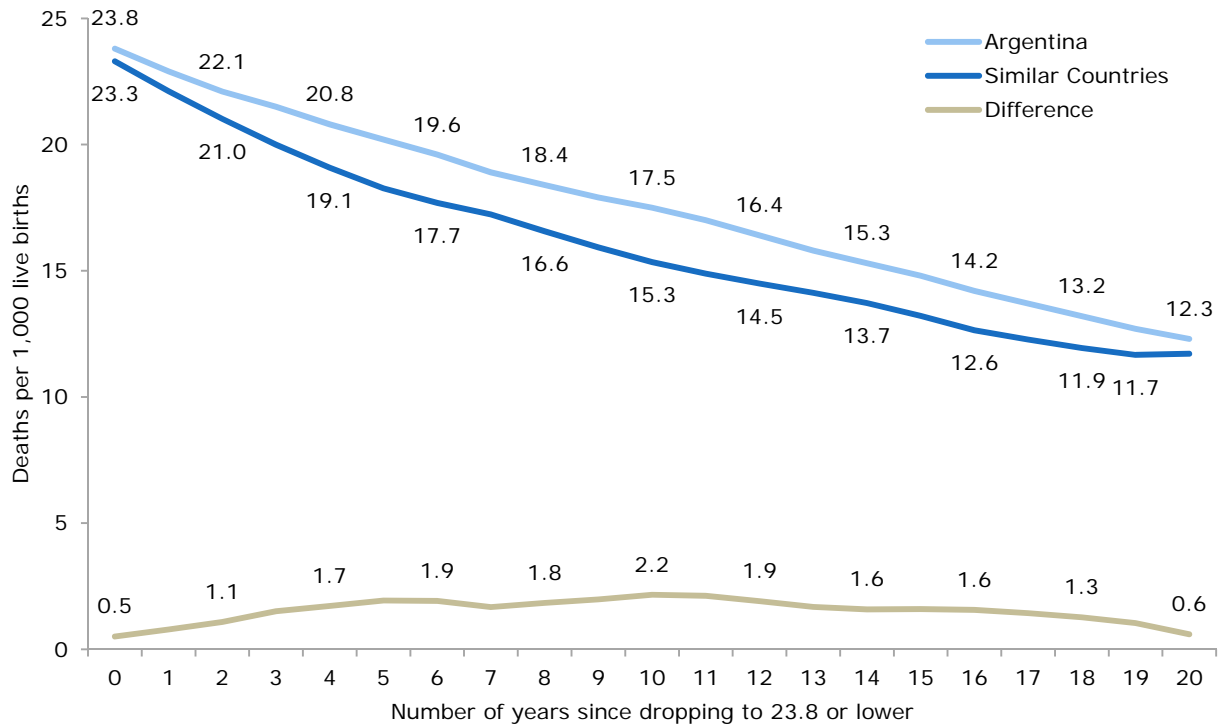
Argentina’s relative progress shows much the same story in child mortality. Though it has roughly halved its child mortality since 1990, for the first decade its progress was much slower than that of its peers (see **Figure 8**). By 2000, child mortality was 10 percent higher in Argentina than in its peer countries: 19.6 compared to 17.8 deaths per 1,000 children under age five. As with infant mortality, this performance gap slowly narrowed in the next 10 years, until Argentina actually surpassed its peer countries in 2010, continuing to make progress while its peer countries on average saw a slowdown in progress.

8 Ministerio do Desenvolvimento Social e Combate Fome (2011) and Programa de Desarrollo Humano Oportunidades (2011).

9 Using the IMF’s income groups.

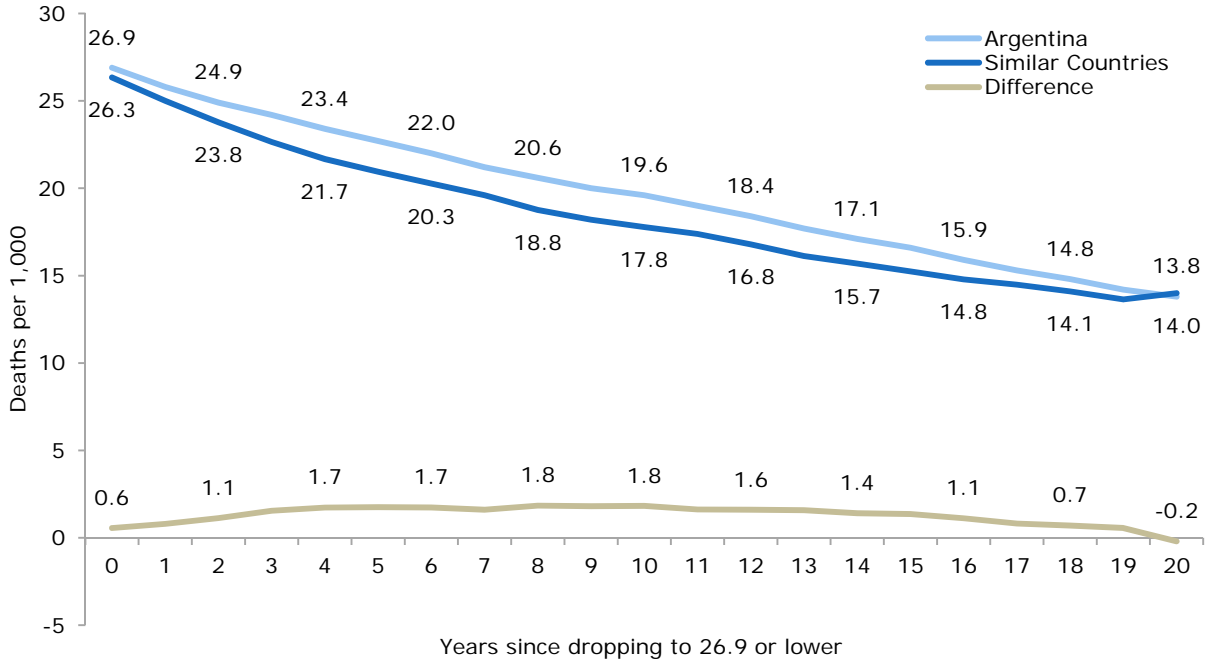
10 In their first year of lowering infant mortality to 23.8 or lower, it is much more likely for rates to be slightly below 23.8 than to be exactly 23.8. Thus, the gap does not begin at zero.

FIGURE 7
Argentina: Infant Mortality, with Comparison to Similar Countries



Note: The similar countries represent a cohort of peers for Argentina. Their progress was averaged every year beginning with the first year their infant mortality rates dropped below 23.8. See Weisbrot and Ray (2001) for a detailed explanation of a similar methodology. Source: World Bank (2011) and authors' calculations.

FIGURE 8
Argentina: Child Mortality, with Comparison to Similar Countries



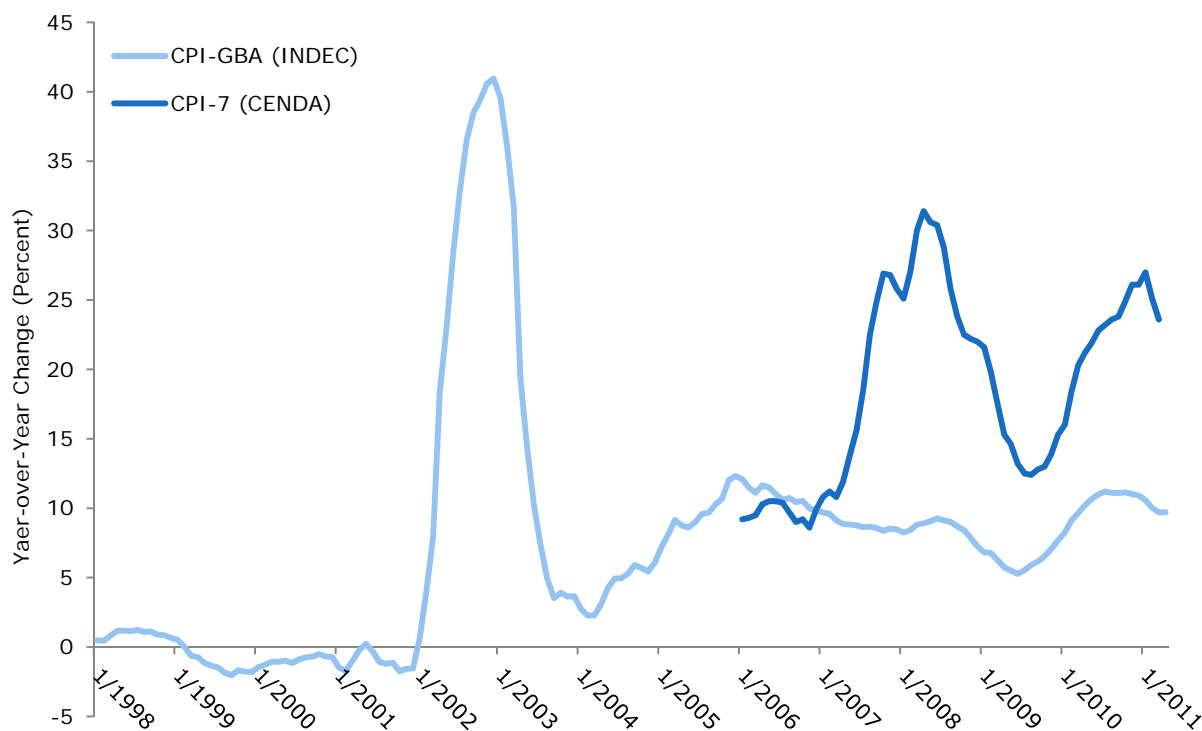
Note: The similar countries represent a cohort of peers for Argentina. Their progress was averaged every year beginning with the first year their child mortality rates dropped below 26.9. See Weisbrot and Ray (2001) for a detailed explanation of a similar methodology. Source: World Bank (2011) and authors' calculations.

Inflation and the Real Exchange Rate

Figure 9 shows inflation as measured by the CPI (Consumer Price Index) from INDEC (the National Institute of Statistics and Surveys), which is the main official government data; and the CPI-7, as measured by CENDA (an independent Argentine think tank). Many private economists believe that inflation is considerably higher than the CPI; private estimates are closer to the CENDA measure. The CPI-7 measures inflation by looking at the change in consumer prices in seven different provinces while the official CPI only measures prices in the Greater Buenos Aires area. We have included both estimates here.

Argentina's inflation is one of the main emphases of most press reporting on the economy. It is often noted that – according to the CPI-7 and private estimates – Argentina has had one of the highest inflation rates in the hemisphere in recent years. Inflation quickly retreated from the brief spike brought on by the devaluation in 2002; but there was another jump in 2007-2008 that brought inflation to 31 percent. It retreated considerably as the country slid toward recession in 2009, to 13.2 percent. It then peaked again at 27 percent at the beginning of 2011, before beginning to decline somewhat again.

FIGURE 9
Inflation: Official and Independent Measures



Sources: INDEC (2011) and CENDA (2011).

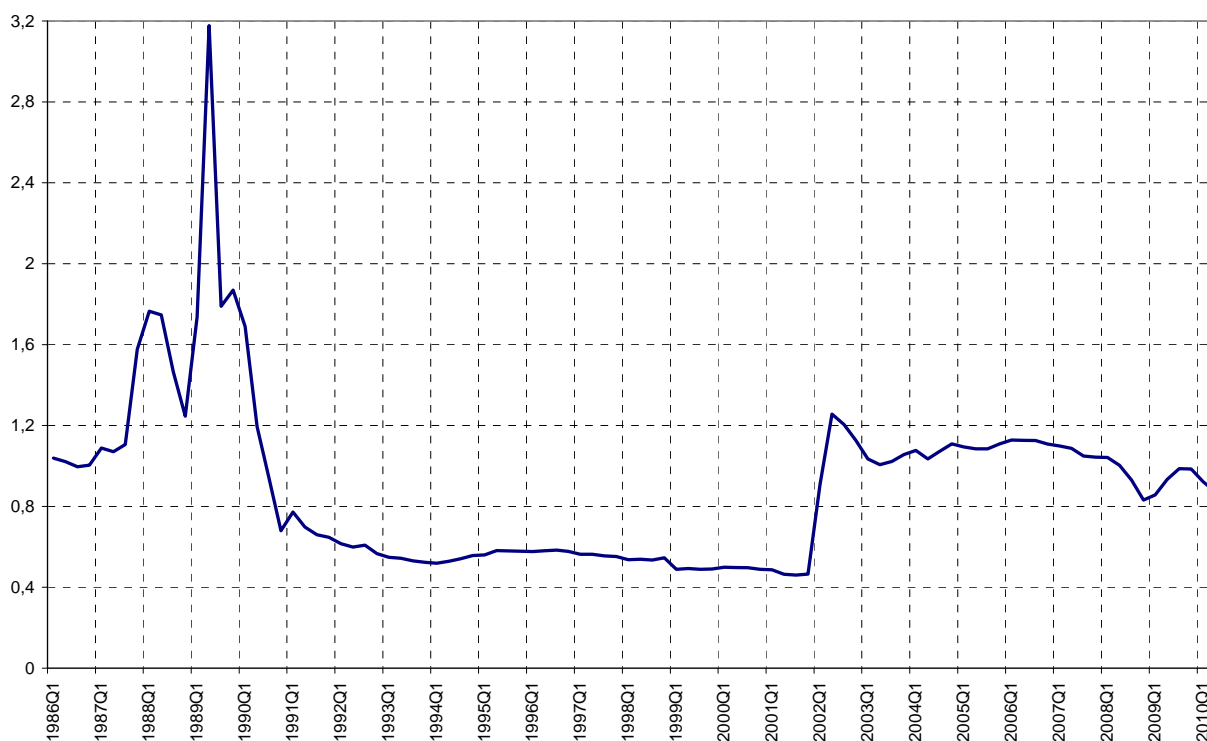
Note: As measured by the CPI from INDEC, and CPI-7 as measured by CENDA.

Inflation may be too high in Argentina, but it is real growth and income distribution that matter with regard to the well-being of the vast majority of the population. By these measures, as we have seen above, the government appears to have made the correct decision not to fight inflation by sacrificing economic growth. . To take one important historical example, South Korea registered annual rates of inflation similar to those of Argentina in recent years, in the 1970s and early 80s, while it traversed the journey from a poor to a high income country.

However, inflation at this level can affect growth and employment through the exchange rate. If the nominal exchange rate is fixed or does not depreciate sufficiently in response to the inflation, then the domestic currency becomes increasingly overvalued in real terms. This happens each year that Argentina has inflation higher than its trading partners, and the peso does not depreciate enough to make up for the difference between domestic and foreign inflation rates.

Figure 10 shows Argentina's Real Effective Exchange Rate. The peso fell sharply¹¹ in response to the devaluation. Then there was a correction for "overshooting," and the peso appreciated somewhat, remaining fairly steady until 2007. Then it appreciated significantly in real terms relative to its trading partners, by about 19.8 percent. If inflation continues at current levels, it will be difficult for the government to carry out its policy of targeting a stable and competitive real exchange rate, and that could hurt the economy by making exports and import-competing industries less competitive.

FIGURE 10
Argentina's Real Effective Exchange Rate



Source: Frenkel (Forthcoming).

¹¹ Since it is the cost of the dollar (or foreign currency) in terms of pesos is being measured in the graph, the jump corresponds to a depreciation of the peso.

Policy Implications of Argentina's Experience

Argentina's economic policies have proven, over the last 9 years, to be very successful by a host of measures examined above. It is remarkable that this has been achieved in the face of adverse external circumstances, some of which continue to this day. Just one month ago the Obama administration, under pressure from "vulture funds" and their associated lobby groups,¹² announced that it would oppose multilateral loans to Argentina.

The success of Argentina's macroeconomic policies, including the central bank's targeting of a stable and competitive real exchange rate and its reluctance to sacrifice economic growth in order to hold inflation to a particular target, deserve more attention than they have gotten. But perhaps the most important implications of Argentina's story over the past nine years are for Europe, including the weaker eurozone economies.

Figures A1 through A5 show (see the **Appendix**) the IMF's latest projections for the weaker eurozone economies. Greece, which has been pursuing policies similar to those adopted by Argentina during its 1998-2002 recession, is expected to need more than 9 years to reach its pre-crisis level of GDP. Unemployment, which is currently at 16 percent, could take even longer to reach normal levels. Trend level GDP is nowhere in sight.

The situation of the other eurozone economies is similarly bleak, if not as terrible as that of Greece. None can foresee a return to trend-level GDP. The number of years to reach pre-crisis GDP ranges from five for Spain to at least nine years for Ireland and Italy. But these forecasts may turn out to be, as the projections of the last few years have been, overly-optimistic.¹³ Unemployment is currently 21 percent in Spain and shows no sign of dropping to normal levels in the near future.

The attempt to adjust through "internal devaluation" in Europe is proving to be as much a disaster there as it was for Argentina in its deep 1998-2002 recession. The biggest risk for Europe at present is that continued policy errors will push Italy down a similar road that Greece has followed. Greece's debt-to-GDP ratio when it signed its first agreement with the IMF in May of last year was 115 percent of GDP; it is expected to hit 190 percent of GDP next year. As can be seen in **Figure A3**, the IMF has already lowered Italy's growth projections significantly over the past six months, because of the 54 billion euro austerity measures that the government has adopted under pressure from the European authorities or "troika" (the European Commission, the European Central Bank, ECB, and the IMF). This raises the prospect of Italy following the path of Greece, where deficit reduction targets get increasingly more difficult because of falling revenues, to which the authorities respond with further fiscal consolidation, and so on in a downward spiral of falling income and a rising risk premium and therefore higher interest rates on the country's sovereign bonds. The whole regional economy has been thrown into a state of crisis and uncertainty which will likely not be resolved until the European authorities can find a way to guarantee Italian and Spanish bonds, or they move away from the failed, pro-cyclical policies that they have implemented.

12 Including most notably the American Task Force on Argentina (<http://atfa.org/>). For more information on this topic, see Weisbrot (2009).

13 See Weisbrot and Montecino (2010).

From the point of view of any of the individual governments that are being subjected to this process, the Argentine solution involving a default large enough to reduce the country's debt burden to a manageable level would have to be considered as a possible alternative. For Greece at this point, for example, this could very possibly be preferable to its current trajectory, even if it were to involve leaving the euro.

Argentina's experience calls into question the popular myth, as noted above, that recessions caused by financial crises must involve a slow and painful recovery. Argentina's financial crisis and collapse were as severe as that of almost any country in recent decades; and yet it took only one quarter after the default to embark on a rapid and sustained recovery. This is not only because of the devaluation and improved macroeconomic policies, but because the default freed the country from having to be continually hamstrung by a crippling debt burden and by pro-cyclical policies imposed by creditors. It is these types of policies, along with the ultra-conservatism of central banks like the present ECB, that mostly account for the historical experience of delayed recoveries after financial crises. The Argentine government has shown that this bleak scenario is just one possible outcome, and that a rapid recovery in output, employment, poverty reduction, and reduced inequality is another very feasible path that can be chosen.

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Appendix

FIGURE A1
Greece Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)

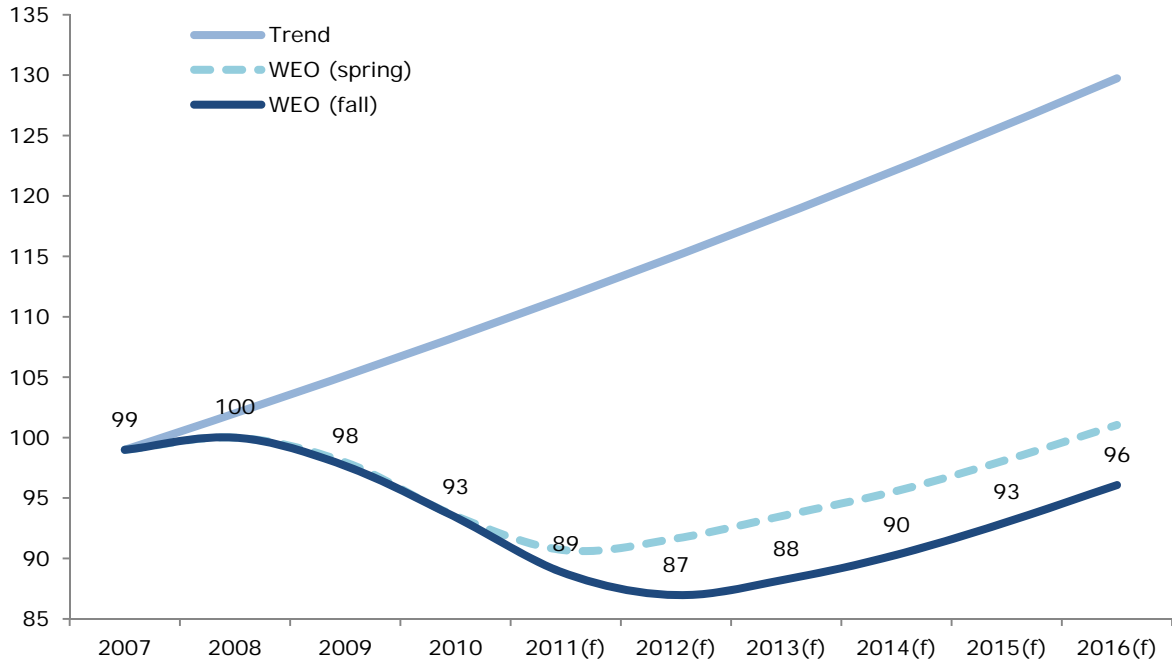
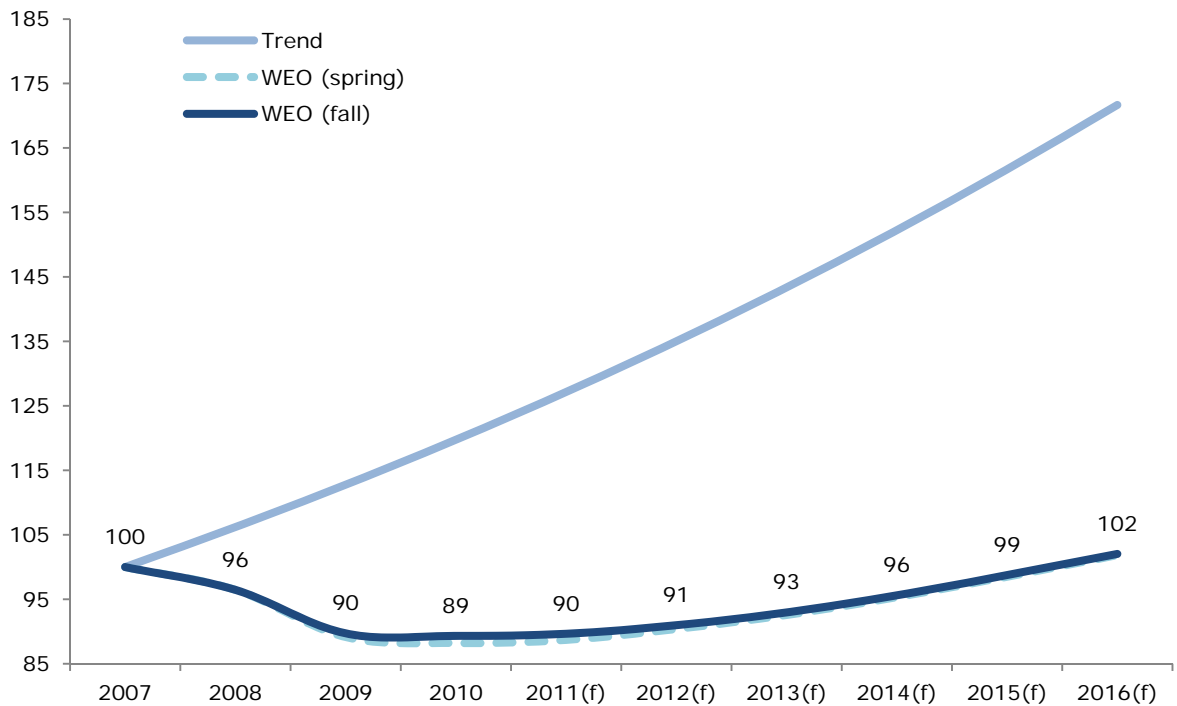
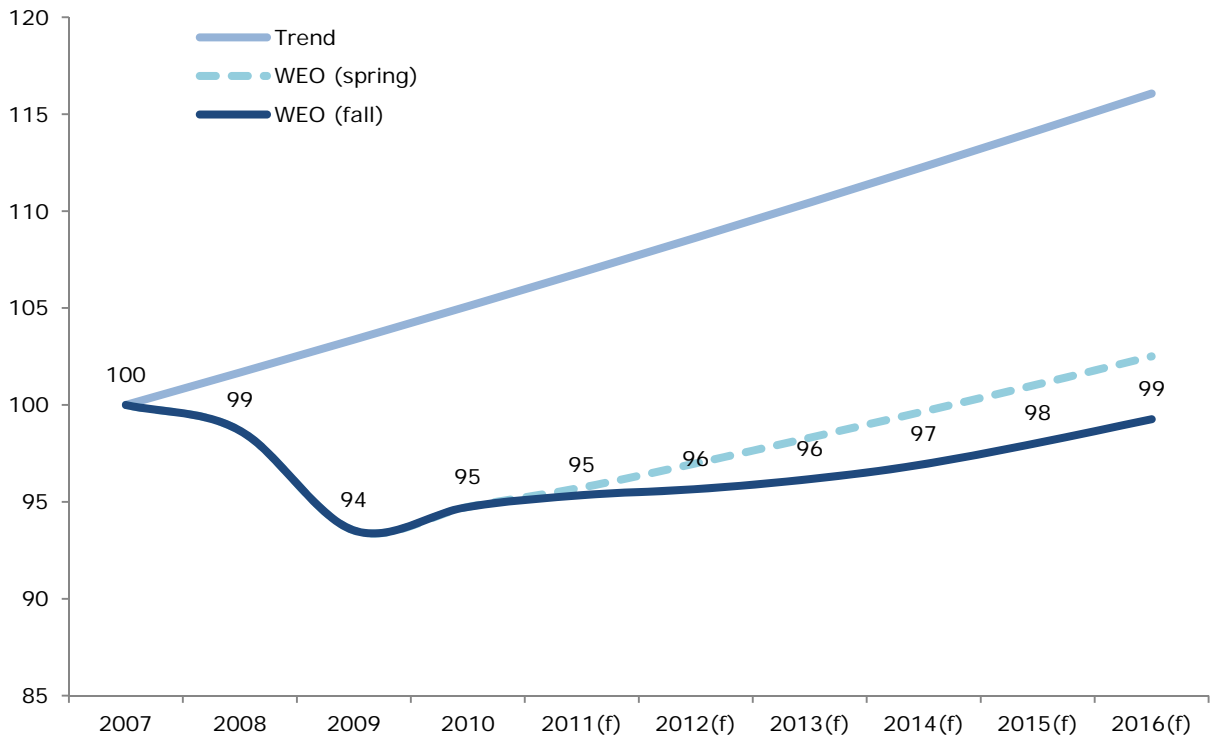


FIGURE A2
Ireland Real GDP: Actual, Projected and 20-Year Trend (Index:2007=100)



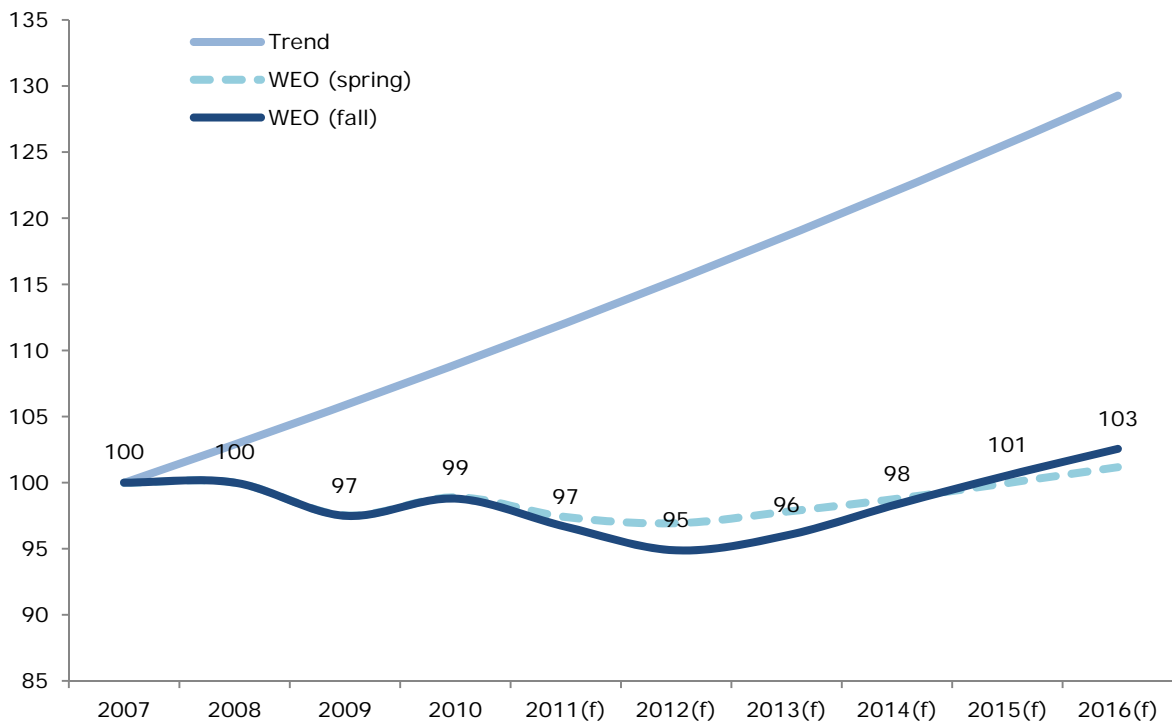
Source: IMF and Authors' Calculations.

FIGURE A3
Italy Real GDP: Actual, Projected and 20-Year Trend (Index:2007=100)



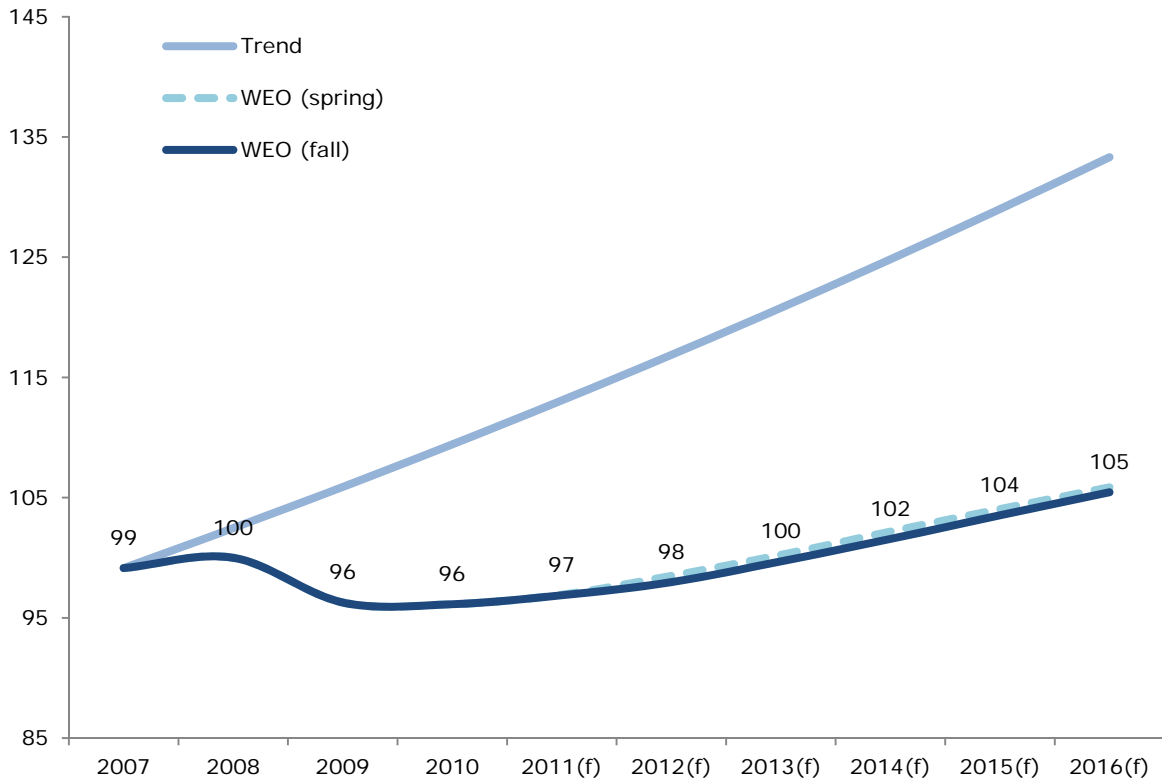
Source: IMF and Authors' Calculations.

FIGURE A4
Portugal Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)



Source: IMF and Authors' Calculations.

FIGURE A5
Spain Real GDP: Actual, Projected and 20-Year Trend (Index:2008=100)



Source: IMF and Authors' Calculations.