

Chapter 17 Update

Currency Boards

Argentina's troubles began in July 2001 when it was required to significantly increase interest rates on its Treasury bills in order to attract investors. By December 2002, the situation had become dire. Despite ongoing talks with the IMF and limits on cash withdrawals within the country, all eyes began to focus on the country's US\$135 billion public debt, and speculation grew that a devaluation was imminent, despite (typical) denials by President Fernando De la Rúa. Indeed, the debt default came immediately in 2002, and the government began to prepare for a devaluation. Initially, the government attempted a 30 percent devaluation, adjusting the peg from 1.0 to 1.4 pesos per US dollar. By June 2002, however, it had reached nearly 4.0 to the dollar, later appreciating back to approximately 3.5 to the dollar. The 2001 Argentine crisis proved to be devastating, with a drop in GDP on the same order of magnitude to that in the United States during the Great Depression. Close to one fourth of the population became extremely poor, while one-half of the population fell below the national poverty line.¹

As a result of the crisis, Argentina stopped serving its debt at the very end of 2001. This was the largest case of sovereign default in history. By the end of 2003, Argentina's total public debt stood at nearly US\$190 billion. By the beginning of 2005, its value amounted to 75 percent of the country's GDP, up from 35 percent in 1994 and 64 percent at the time of the crisis. By the end of February 2005, the country had negotiated a debt swap, which replaces a portion of this debt with lower-value bonds. The total effect of this swap will be to reduce the debt to approximately US\$120 billion. The government hopes that this restructuring will begin to bring home the approximately US\$150 billion its citizens hold abroad in the form of flight capital.

References

The Economist (2005) "Argentina's Debt Restructuring," March 3.

Fiszbein, A., P. Giovagnoli, and N. Thurston (2003) "Household Behavior in the Presence of Crisis: Evidence from Argentina, 2002," World Bank, Washington, DC.

¹ See Fiszbein, Giovagnoli, and Thurston (2003).