

As economy minister in the early 1990s, Cavallo guided Argentina's economic policy of deregulation and privatization and designed the Convertibility Plan. He returned as economy minister in 2000.

Cavallo discusses Argentina's structural reform of the 1990s, the internal and external shocks and influences on Argentina's economy, and the country's current financial crisis.

Learning from the Past: Dependencia, Chilean Reform, and Bolivian Hyperinflation

INTERVIEWER: [The first *Commanding Heights* episode] is about the battle of ideas. Can you tell me the evolution in your own thinking? I know when you started out as a young economist that dependencia was the dominant thinking in Latin America. Can you talk to us about dependencia?

DOMINGO CAVALLO: Yes. In the University of Córdoba where I studied, several professors explained this theory, dependencia, and particularly the theories that came from CEPAL or ECLA from the United Nations, Dr. [Raul] Prebisch's idea on the deterioration of terms of trade for underdeveloped economies. And the theory was that somehow the central economies manage to force permanent reductions in their prices of raw materials that were produced in the developing world. And as a consequence of that, it was convenient for nations, like Argentina and other Latin American economies, to become more closed and to produce mainly for the domestic market—that we introduce import substitution and all that. Those were the prevalent views. But before coming to the university, I had already started to read on economics. And I read the liberal ideas, economic liberal ideas of the 19th century [when Argentina was founded]. And I was convinced that that was the right approach. So I struggled in a sense with these ideas that I was being taught in the university, you know. So when I started to develop my own approach to our economic problems in Argentina, I mainly used what I had studied by myself from those old books of the 19th century.

INTERVIEWER: Did what was happening in Chile have an impact on your thinking?

DOMINGO CAVALLO: Oh, the experience of Chile during the '80s was very instructive, I think, for most Latin American economies, and many politicians in Latin America, because Chile was successful by opening up and trying to expand their exports and in general their foreign trade

and getting more integrated into the world economy. And they also succeeded in stabilizing the economy during the '80s. So most Latin American economists and a few Latin American politicians looked at the Chilean experience. And of course we used, particularly here in Argentina, the experience of Chile to go ahead with our own reforms. So the experience of Chile was very instructive for us, from the practical point of view, not that much from an ideological point of view. But you know, we saw their reforms in the direction of opening up the economy for foreign trade and in investment and deregulating the economy. And from that experience we were convinced that that was the right approach. And that's why, in Argentina and in many other countries, during the '90s we did implement pro-market reforms.

INTERVIEWER: Did the association with the Pinochet government make it difficult for you to accept some of this, or was that a difficulty in seeing the free-market ideas as viable?

DOMINGO CAVALLO: You know, there were discussions on the feasibility of implementing market reforms in a democracy, because the only experience had been under Pinochet in a dictatorship. But in 1990, President Patricio Aylwin, the first democratic president after Pinochet, maintained the reforms and also tried to improve on them. But keeping the same approach, keeping the economy open to the world ... that facilitated the adoption [of the same approach] by the young democracies of Latin America, because it was demonstrated that it would be possible to implement similar reforms under a democratic regime. So I think that it was the successful transition from dictatorship to a democracy in Chile and the preservation of the reforms that helped to convince particularly politicians that it was good to adopt the same approach.

INTERVIEWER: What about the situation in Bolivia, with the shock therapy? Was that also influential?

DOMINGO CAVALLO: Yes, in terms of how to stabilize an economy, because the experience of Bolivia was instructive, particularly for Argentina, in terms of how to eliminate hyperinflation and how to stabilize an economy. That happened in Bolivia in '85. And, you know, the hyperinflation in Argentina was in '89 and '90. So the experience from Bolivia, how to stabilize a hyperinflationary economy, was helpful for us, particularly for Argentina. I think that it was

also helpful for Brazil and other economies that were running into hyperinflation in those years.

INTERVIEWER: We're trying to explain to people the human effects of something like hyperinflation. Can you?

DOMINGO CAVALLO: Oh, at the time of hyperinflation it's terrible for the people, particularly for low-income people and small savers, because they see that in a few hours or in a few days they are being told their salaries got destroyed by the price increases, which take place at an incredible speed. So that not only destroys the value of savings and the value of salaries and wages, but also prevents the normal functioning of the real economy. So at the same time the country goes into a very deep recession. So you are in the worst of the worlds at a time of hyperinflation. That is why the people ask the government, "Please do something." And if the government comes with a good stabilization plan, that is the opportunity to also accompany that plan with other reforms, which are necessary for renewing growth and making the whole transformation sustainable over time. ...

INTERVIEWER: And those economies [in Chile and Bolivia] now, how are they?

DOMINGO CAVALLO: Chile is doing very well and I think has kept the same rules of the game, and every political party and most of the citizens support the prevalent rules of the game. So I think that Chile has a very good future.

Now, Bolivia could not solve the structural problem that they always had ... [of] the extreme poverty. But I think that requires more and more investment in education, in health care, in human capital. And of course that takes time, particularly in an economy that is very poor, and even though it has been stable for almost 16, 17 years, it has not generated enough incentives to invest in human capital. Or what they have invested [in] has not yet produced the results. But I think an experience like that of Bolivia, one has to look over a very long period of time, because the kind of structural problems that they have to solve are really very difficult and take a lot of time to modify.

INTERVIEWER: So are we asking a lot of globalization to make these transformations so quickly?

DOMINGO CAVALLO: I think globalization is a process that is taking place due to the realities of the nations and of the world. I think that what happens in each one of the countries is the result of the actions of the governments and the actions of all their citizens in this context of globalization. I think the key for the success of the nations is in identifying the opportunities and investing, or facilitating the investment, to use those opportunities and to keep opening opportunities. And that is what Chile did in Latin America, and [it] has been very successful.

We were successful for a while, but now we are in the middle of a very deep recession, in a very deep crisis. But I think one, two, three years in the future we will see many Latin American economies and many emerging economies and nations of the so-called Third World trying again to identify the opportunities offered by the global economy and not being discouraged by the failures of previous years.

The Agony of Reform in Argentina

INTERVIEWER: You wrote a book in I think the mid-'80s about the crises in the economy, and you spoke a lot about the rules of the game. Were you looking at these kinds of things?

DOMINGO CAVALLO: Yes. Actually I was referring to the lack of a monetary system and a lack of a fiscal system and a lack of clear rules of the game in terms of our relations with the rest of the world for foreign trade, for investment. And the governments [in Argentina] up to 1989 and I think '90 were always deciding on new rules of the game in a very arbitrary way, in a very discretionary way. So nobody knew what to do and how to be prepared for the next change in the rules of the game. So I wrote a book saying that Argentina had to adopt the typical rules of the game of a market economy, integrated into the world economy. Argentina needed monetary discipline, and that is why we went into currency convertibility in '91 to eliminate hyperinflation and to impose monetary discipline. But we needed also fiscal discipline; we had been running huge deficits. And by the way, the problems that we are now suffering in Argentina relate to the failure in being strict enough in terms of fiscal policies. But the most important reforms were related to the opening up of the economy and to the deregulation and the privatization process.

But the only way to implement all those reforms was, at that time, to take advantage of the situation created by hyperinflation, because the population was ready to accept drastic changes in order to eliminate hyperinflation and to go back to normality, you know, in terms of everyday life.

INTERVIEWER: When you came into the [Menem] government, what were the things that you put in place for the reforms?

DOMINGO CAVALLO: I was foreign minister before being economic minister, and while I was foreign minister I worked to improve the relationship of Argentina with all the nations of the world, but particularly with United States and Europe. We had been affected in '82 by the war in the Malvinas, the Falklands War, and we had not kept diplomatic relations with the United Kingdom for a decade. So it was necessary to restore the linkages, the relationship between Argentina and Europe and Argentina and the United States, and of course with our neighbors, because Argentina was very closed, not only in the economic sense, but also in the political sense and as a society. So I started working for the opening of Argentina, at least in terms of diplomatic and political relationships, with the other nations, as foreign minister. And then in February '91 I was appointed economic minister, and in two months I prepared a convertibility program, which we implemented starting the first of February of that year, and we succeeded in eliminating hyperinflation and stabilizing the economy.

That made room for implementing all the other reforms which, of course, I had in mind, because I had written about [them], and we had the experience of Chile. In general, it was very clear that we had to open our economy to the rest of the world and to work for a larger share of foreign trade into our economy and bring foreign direct investment into the economy and to recreate a climate of investment in general and doing business in Argentina.

INTERVIEWER: And when did you institute the privatization?

DOMINGO CAVALLO: Simultaneously with the convertibility program, starting in '91. Actually, there had been some privatizations the previous year. When I was foreign minister, the previous economic ministers had implemented a few privatizations. But as a broad program

including oil, natural gas, electricity, transportation, and other public utilities, even water, we did that in '91, '92, [and] '93.

INTERVIEWER: We talk about the agony of reform. In privatizations, many thousands of people are laid off from their jobs. How did you handle that?

DOMINGO CAVALLO: Yes, that's the big problem. All the state-owned companies had been creating artificial jobs, very low productivity. But in a way they provided a sort of unemployment insurance. In restructuring those companies after privatization, of course, there was a significant reduction in employment. In the case of Argentina, it was around 700,000 people from an active population of 14 million people. So 700,000 is a large number. But at the beginning, in '91, '92, '93, the private economy was expanding very rapidly as a consequence of the new opportunities offered by the opening of the economy and also the jobs that were created by the inflow of foreign capital, particularly foreign direct investment. And the investment in the privatized sectors themselves, all that created a new job opportunity. So we did not go into a significant unemployment problem at the beginning. But as the economy started to lose vitality in '95, at the time of the Tequila Crisis [the Mexican peso crisis and its effect on other emerging markets] and its impact in Argentina, and afterwards of course, unemployment started to increase. Nowadays in political discussions in Argentina, everybody blames the privatization for the unemployment. It is clear that the level of employment was drastically reduced as a consequence of the privatization. That was the other side of the coin of the increased productivity. ...

And actually during four consecutive years the economy grew very fast in Argentina. Those were the years of success of the reforms, and the population supported the reforms. Then came the period of crises, the impact of the Tequila Crisis and other crises. And finally we actually went into a sort of an agony period, and that was starting in the second semester of '98, after the Russian crisis; that had some impact. But particularly [the agony followed] the Brazilian crisis; that had a very negative impact on Argentina in '99. [There was] not only the impact of the crises that came from abroad, but also the excessive spending by the provinces during '97, '98, and '99, and the consequent excessive borrowing by the local governments. Their indebtedness was the source of the crisis that we are suffering today in Argentina.

Successful Reforms Require Cultural Change and Austerity Measures

INTERVIEWER: So the economic measures have to go hand in hand with some political, cultural change?

DOMINGO CAVALLO: Oh, yes. It's very necessary to be successful in implementing these broad economic reforms that try to integrate the national economy into the global economy. It is crucial that at the same time there are cultural and political changes that take place in the same direction. And in a sense that is what failed in many Latin American countries, and particularly in recent years; it was the source of the crisis that we are going through in Argentina. You know, the fact that many politicians continue with a demagogic attitude and populism and clientilism, customerism, as we call it, in our country—this spending too much in a discretionary way to benefit some groups, and at the same time other groups of the population have to pay the price for those benefits, and that makes the fiscal policy particularly unsustainable.

INTERVIEWER: So what do you say to people who held Argentina up as this wonderful model of the reforms and [stable] growth and now [are] watching what's happening in Argentina today? As the world is globalizing, we're also much more connected. What do you say to other countries?

DOMINGO CAVALLO: I would say that it is very important not to use too much financing... particularly not to use it too much for financing large deficits of the local governments or of the national government. In a sense, during the years when an economy that goes through these reforms produces a good result, it creates favorable expectations, and then it is very easy to get financing. But the financing should be used for implementing good investment projects, not for financing excessive spending of the governments, particularly in nations like ours, where the political ideology has not changed in the direction of austerity.... In general, political parties and politicians continue to look for their own position in the political system and the benefits of some small groups that are their supporters.

INTERVIEWER: So when you mention austerity measures, who do those hurt the most?

DOMINGO CAVALLO: You know, the austerity measures that should be implemented should prevent excessive spending by the bureaucracy and the politicians, but should not eliminate the financing for health care and education and social programs in general. But what happens is that, even though the speeches and promises of the politicians normally are related to education and health care, what always increases is the bureaucracy and the special benefits for people linked somehow to the political system, and not that much to the supplier of good public goods.

INTERVIEWER: So you think that it's not an example of the market [failing]?

DOMINGO CAVALLO: Not at all, not at all. Look, it is not the market and the market economy that failed in Argentina and in other countries that went through this deep crisis; it's mainly the lack of austerity and rationality in the use of public resources, and also large tax evasion generated also by very distorted tax systems. So it is mainly the economy of the public sector which generates the crisis rather than the working of the markets and the private companies.

INTERVIEWER: But this crisis here and in other places has created quite a backlash against [the free market]. [The crisis is] seen as a market problem.

DOMINGO CAVALLO: Yes, actually those that always predicated the socialism or the old ideas, let's say, in the past and continue to say in the present that the markets do not solve the problems use these crises as examples of market failures and they propose a larger degree of state interventionism in the economy. But I think that globalization, in practice, forces most governments to take into account the budget constraints that are not an imposition of the economists but of reality on the public sector. And finally, when [politicians] are in government, [they] come to the conclusion that they have to rely on the markets to create the investment opportunities and to attract private investment, and that way they will be able to collect taxes and to provide financing for the expenses of their governments and the public sector. So, you know, there is a lot of discussion in terms of ideology, particularly prior to an election. But once a government, even if it is central left or rather leftist, goes into government, it has to work according to the realities, you know, to face the realities. And that forces them to be austere, or to try at least to be disciplined.

The Importance of Free Trade and Monetary Stability

INTERVIEWER: And so the reality is to have open trade?

DOMINGO CAVALLO: No doubt, no doubt, because if you do not use the opportunity for growth that comes from trade with the rest of the world, and if you do not allow investment, foreign and domestic, to find opportunities to make the money, you do not generate growth. And if you do not generate growth, you cannot collect taxes, and then you cannot pay for the expenses of the government.

INTERVIEWER: So the tendency to close off the economy is still not an appropriate response....

DOMINGO CAVALLO: There may be some years in some particular countries, maybe even in Argentina, where the speeches will be in the direction of closing again the economy. That is actually what is happening now in my country. But I think that once a particular government, like this new government in Argentina, starts to work to find solutions for the problems, it immediately realizes that closing up the economy only aggravates the problems, particularly if it closes investment opportunities, because most of the investment opportunities nowadays are related to the global markets more than to the very small, local market, particularly the investment opportunities in those sectors of the economy that generate productivity increases, which are very important for making growth sustainable in an economy. So even though the speeches, the political discourses may be in the direction of closing the economies as a consequence of the crises which are associated with globalization and the previous process of opening up, in a few years I think governments, even those that are more to the left, will come to the conclusion that they have to preserve [an open] economy and try to increase foreign trade, and particularly to create a good environment for investment—domestic and foreign investment—into the country.

INTERVIEWER: You've spoken about the rules of the game. So what would those rules be that would allow for investment?

DOMINGO CAVALLO: No doubt some sort of monetary stability is crucial, because in general, nobody invests in countries that have inflation; secondly, fiscal discipline, because of course if

an economy doesn't have fiscal discipline, it has to borrow on a [continual basis], and [that] generates this kind of debt problem we are now suffering in Argentina. But more important than monitoring fiscal discipline is competition and removal of distortions, both in terms of the trade with the rest of the world, but also inside the economy, domestic trade. [It is important to stimulate] entrepreneurs and workers and everybody to try to become more efficient in what they do on a continuous basis....

INTERVIEWER: But the terms you're using are these economic [policy] terms. What about people who now say that the peso pegged to the dollar, and now the eventual devaluation, has taken away much of their savings and they are very angry?

DOMINGO CAVALLO: Oh, no doubt the devaluation, and particularly the way Argentina has devalued its currency without defining the new rules of the game for the monetary and exchange system are very damaging for the low-income people and also for the small- and medium-size depositors in the banking system, because it erodes the savings and it reduces the real wages exactly as devaluation and inflation did in the '80s and '70s in Argentina and in other Latin American countries. That is why these days you see in my country even more anxieties than some months ago when we were in recession, but at least we had been able to preserve a monetary stability. So I think in every country, and particularly in my country, to renew growth and to improve the expectations of the people and to reduce the suffering of the population, it is crucial to restore a monetary and price stability. So I think we will go somehow to a process similar to the one that brought currency convertibility in '91. But it will be after the negative consequences of a period of instability, like the one that we are suffering now.

INTERVIEWER: So you continue to think that you would have kept the peso pegged to the dollar?

DOMINGO CAVALLO: Actually, what I would have done in '98, after the Russian crisis, is to move at that time from a peg to the dollar to a peg to half the dollar, half the Euro. I would have adopted the basket of the two currencies. And if we had had that, then the peso would not have become so overvalued, because the euro devalued a lot all along '99 and the year 2000, almost 30 percent vis-a-vis the dollar. So if we had had the peso pegged both to the

dollar and the euro, we would not have suffered from an extreme appreciation of the peso, which called for very severe fiscal adjustments and we were unable, finally, to implement it. And that is why we went finally into this debt crisis and this currency crisis.

International Financial Crises and Their Impact on Argentina

INTERVIEWER: If we can go back to the Mexican peso crisis, and then I'd like you to extend that to the Asian financial crisis, the contagion effect as it moved to Russia and then to Brazil—[what was] the impact of the external factors on your situation?

DOMINGO CAVALLO: The first crisis that had a significant impact on Argentina was the Tequila Crisis. Actually, we did not have at that time, and we do not have today, large commercial or investment relations with Mexico, but in the financial markets, Argentina was seen in those days as the second successful case of deregulation, privatization, and stabilization. The first one was Mexico. So when Mexico suffered the devaluation of the peso many people said, "Oh, the next country to devalue the currency and to have a problem will be Argentina." So that prediction generated a sudden capital outflow from Argentina. And also the depositors in the banks started to withdraw their savings and send them abroad because they were scared.

There were also some problems in Argentina that aggravated the crisis. The problems were mainly that provincial banks had continued lending to the provincial governments to finance large deficits of the local governments. So what we did at that time in March, April '91, just a few weeks before a very important presidential election, was to force the privatization of the provincial banks, most of the provincial banks, and get foreign money through the IMF, the World Bank, the IDB [Inter-American Development Bank], and also private banks, foreign and local private bankers that added funds to demonstrate that we did have the ability to control the situation. And we were successful. Actually in a few months, Argentina started to get capital back into the economy, and deposits in the banking system started to increase. So we succeeded in preventing the devaluation and a financial crisis in '95. But there was a recession that year.

[Then] in '96 and '97 the economy was growing again very fast, and Argentina continued very successfully, [even] at the time of the Asian crisis. The Asian crisis had no significant impact on Argentina—not even the Russian crisis, because even though those currencies devalued

vis-a-vis the dollar, as our trade was mainly with Europe and with the United States and with Brazil and other Latin American countries, those devaluations did not affect Argentina. And as, during the '95 crisis, Argentina had demonstrated to have a good currency system and a strong financial system, there was no financial impact on Argentina. But after the Russian crisis, the spread in financial markets for all emerging economies started to increase; interest rates started to increase. So that did have some effect.

There were some signals of recession in the second semester of '98. What was very negative for Argentina was the collapse of the Plan Real in Brazil and the large devaluation of the real [Brazilian currency]. Of course that happened in January, February '99. And since then the situation worsened a lot in Argentina. We could not devalue the peso because we were tied by our currency system to keep the value of the peso equal to the value of the dollar, so the only way to dampen the negative effect of the devaluation of the Brazilian currency was to reduce cost of production in Argentina, to work on the supply side of the economy to try to increase productivity. And we should have been very austere and reduced government spending. Unfortunately, in '98, in '99 there was strong competition between [Eduardo] Duhalde, who was the governor of the province of Buenos Aires, who wanted to be candidate for the presidency, for the election of October '99, and on the other hand [Carlos Saul] Menem, who had been president for two terms and wanted to reform the constitution to allow for a third term. And in the competition for the candidacy both of them, Duhalde as governor of the province of Buenos Aires and Menem as president, encouraged all the provinces to overspend and overborrow. They borrowed a lot, not from the provincial banks but from the private banks. And it was that excessive borrowing that created a debt problem, additional to, you know, the debt problem that was being created by the increased debts of the national government.

And it was that problem created by the overspending of the provinces that made it very difficult for the de la Rúa government in 2000 and 2001 to actually keep the fiscal deficit under control and to finally convert to a stable situation.

INTERVIEWER: It seems to me what you've been describing is the difficulty of navigating in this new interconnected, globalized world where things very far may affect you. What was your experience of this?

DOMINGO CAVALLO: You know, the instability of currencies, it's a problem for the national economies, particularly for economies that had a long experience of inflation, like Argentina and many other emerging economies.

The Making of Argentina's Crisis: Who's to Blame?

INTERVIEWER: You mentioned you had a difficulty with Menem on some of the privatizations. There have been suggestions of corruption in privatizations worldwide. What do you say to that? [And is this why you left his government?]

DOMINGO CAVALLO: No, it was mainly a disagreement on the way he wanted to conduct some privatizations that we had not yet finished, because ... there was a group of businessmen, not very well known actually ... people that had been hiding their identities and worked like a sort of Mafia, that had been controlling informally the postal services, the airports, and other very sensitive areas. So I wanted to privatize those services by getting a lot of competitors into those markets, or at least getting a lot of businessmen participating in the privatization.

And, of course, these people that had some influence on Menem or on Menem's friends wanted to get this company for them without competing. So that was mainly the struggle that we had in those years, and of course, one could characterize this as a discussion on corruption, but I think that it was mainly a discussion on how transparent and competitive it had to be the process of privatization.

... [O]ur discussion with Menem related to the importance of transparency and competition in the process of privatization. I wanted to have as much transparency and as much competition as possible, and there were economic groups linked to Menem or to Menem's friends that wanted to get these companies without competing and without enough transparency in my opinion. So I do not want to call that corruption, but we completely disagreed on the methodology for these remaining privatizations.

But actually when I left the government in '96, Menem had already in mind being candidate for the presidency in '99, and it was the competition between Menem and Duhalde, who was then governor of the province of Buenos Aires, that generated the huge overspending by the

provinces in '97, in '98, and '99, which I think is the origin of the current crisis, because excessive spending and excessive borrowing by the provinces generated these debt problems and aggravated the overvaluation of our peso.

INTERVIEWER: But how can these political problems ever be separated from [economic policy]?

DOMINGO CAVALLO: It's impossible to separate them; this is reality. And that is why, in most of the countries, you go through crises, and sometimes through very deep crises. Now, if it were possible to program economic reforms and political reforms and have all the politicians doing the right things and preventing the mistakes, there would be no crises. But, you know, the world is imperfect. Every country is imperfect because our society and each one of us is an imperfect person, so we make mistakes. All of us make mistakes, and when the mistakes accumulate in the political arena and economic arena, then you'll generate these very deep crises. I am very sad that Argentina, [which] had several years of success, finally went into this very difficult crisis we are in now.

INTERVIEWER: So how would you characterize this current crisis? Is it a crisis of confidence in the markets, or is it a crisis of confidence in the government?

DOMINGO CAVALLO: Oh, no doubt it's a crisis of confidence of the public in the government, the federal government, provincial governments. It is very clear that the origin of this crisis is the excessive spending by provincial governments, to some extent also the federal government, and the attempt to finance that excessive spending by tax increases which aggravate the competitiveness problem.

Of course, competitiveness or lack of competitiveness originated in the extreme appreciation of the peso due to the peg to the dollar. But the fact that the provinces and the central government were spending too much forced on one side to borrow, and that helped to increase interest rates and also the interest costs for all the private sector. Plus it induced tax increases, particularly those decided by Menem's government in '98 and '99 and by the de la Rúa government in the year 2000. Those tax increases increased cost of production for the

private sector, so they aggravated the lack of competitiveness that had its origin in the overvaluation of the peso.

So the combination of the excessive spending and these other measures that were adopted to try to finance this excessive spending created this deeper crisis that we are suffering in Argentina. So no doubt it is lack of confidence in the action of the governments, provincial and federal governments, not in the markets.

INTERVIEWER: But it seems that the public blames the reform process for bringing some of this about.

DOMINGO CAVALLO: Look, if you hear in the radio what the public says, you will see that they criticize excessive spending by the politicians, or the so-called excessive cost of politics. So I think the public in general understands what is the origin of the crisis.

I think the politicians blame the currency system, this convertibility, blame the IMF, blame Cavallo, blame whoever they like to suggest that they are responsible for this crisis. But I think the Argentineans realize that it's excessive spending by the politicians.

When they blame me it's because they also see me as a politician, because I was so many years in government, particularly in the last nine months or so in 2001, prior to the deepening of the crisis. So they blame me, not because I gave a lot of emphasis to promoting ... increased productivity by the private sector. They blame me, like most other politicians, because they consider that we spent too much and that we were not disciplined enough, or we did not impose enough discipline on politicians to cut spending. So I don't think that it is the public that is generating the change of ideology, I think it is the political class that were always supporters of some sort of socialism that now see the opportunity to start again with their old ideas. But I think reality will force them to continue with the pro-market reforms. Of course, [this will be] after the new government finds the way to establish again the economy.

INTERVIEWER: But the pot-banging—I'm not sure what the Spanish word is—is being copied in other countries as a symbol of an anti-market...

DOMINGO CAVALLO: No, but it is not anti-market. You know, the public is very angry because they cannot use their deposits in the banks, and now they see that their deposits are being eroded by devaluation and eventually inflation. And of course that makes them very angry. In addition, there are the unemployed and the very low-income people that have been suffering during all these years of recession. But I don't think that the people are requesting more spending by the government—for sure not by the politicians. If they request more spending, it would be in health care for the poor, health care for the pensioners, in education for the children. Of course in every country people want the government to supply those public goods.

INTERVIEWER: So have those areas been hurt by this suffering economy?

DOMINGO CAVALLO: Yes, they have been hurt, but not by low spending. Actually spending was very large, but not in those essential services, but mainly in bureaucracy and this political apparatus.

INTERVIEWER: So what would you say to the people who blame the IMF?

DOMINGO CAVALLO: You know, the IMF, like the World Bank, like the IDB, they provided a lot of financing for Argentina. Of course in November particularly, the IMF decided to delay a disbursement of a loan that had already been agreed upon. But they wanted the budget for the year 2002 approved, and I think their request was reasonable. Unfortunately, the de la Rúa government in which I was the economic minister was unable to get support in Congress for approval of that budget. And then there were all these complications that have been reported widely.

But it is not the international agencies that will do the job of preparing a good plan and implementing it; it is our responsibility. I mean, the Argentineans have to do it. And that is what we will try to do, I think, this year, and I hope we will succeed. At least that is very necessary for the Argentinean people.

INTERVIEWER: You've spoken about contagion before. Do you think that there's a chance that this crisis in Argentina will prove to be contagious?

DOMINGO CAVALLO: Not through financial or trade mechanisms, but through this ideology that is reviving as a consequence of this crisis. But I am optimistic in the sense that reality will immediately demonstrate that it is not with the ideas of the '70s and '80s that we will solve the problem, but an improvement of the reforms that were implemented during the '90s that of course were not accompanied by enough fiscal discipline and did not produce simultaneously similar changes in the political and cultural structures of the country. But after this crisis I think that there will be in a sense an improvement of those new ideas, but not an abandoning of them, and a return to the old ideas of the '60s, '70s, and '80s, no.

The Risks and Rewards of Globalization, and the Government's Role

INTERVIEWER: The thinking that led you to establish the currency board was partly grounded in the belief that less government intervention in the economy was better. Is that the case?

DOMINGO CAVALLO: Basically, we had to give Argentineans a currency, a stable currency, because the one that they had been using, the austral, had been practically repudiated by Argentina because it was losing value every minute, and Argentineans were using the dollar. There was widespread use of the dollar.

So basically the idea of currency convertibility was giving Argentineans freedom of choice of the currency they would use. And that worked very, very well to restore stability for I would say seven consecutive years and to restore growth, because it facilitated or re-created the climate for reducing the size of the government and privatizing all the state-owned companies, and all that attracted new investment, but very efficient investment, and generated significant productivity growth and, therefore, growth of the economy as a whole.

So that was the period of success, or the success story. Unfortunately, as I said before, overspending during '97, '98 and '99 by the provinces, by the federal government, excessive borrowing I think combined with all the devaluations that took place in different countries of the world following the Tequila Crisis, the Asian crisis, the Russian crisis, the Brazilian crisis. Of course, the combination of these two phenomena originated and provoked this crisis which is now very, very deep in Argentina.

INTERVIEWER: So an interconnected global economy has some of these risks?

DOMINGO CAVALLO: Yes, but I think that is reality. One has to be aware of these risks, and one has to try to adopt decisions that will reduce the risk and will enlarge the opportunities offered by the global economy. I think that just blaming all these interconnections for the problems and thinking that one can live isolated from the global economy as a very closed economy and then solve the problems is a big mistake. I think that we have to be aware of the risks associated with globalization, but we have to live with globalization and try to find the opportunities within a global economy.

INTERVIEWER: What about the risk of having your own culture, and in fact your political way of doing business, altered because ... the rules of the game would make it a necessity?

DOMINGO CAVALLO: You know, the only thing that globalization imposes on everybody is efficiency. You have to be efficient, and you have to increase productivity, or you have to improve the quality of work you do and achieve better results, because you are competing with others that try to do the same, and if you are not as efficient as he or she, then you lose. But in a sense competition existed always, and it was thanks to competition that there have been continuous improvements in the way things are done by the people.

Globalization in a sense is just enlarging the size of the markets where you find the tough competition. Of course there are winners and there are losers, and the governments should see what is the best way to offer everybody equal opportunities through education, health care, and particularly for those people who are already old, to compensate if they are losers with some degree of social benefits and social safety net.

But I think the key for the success of a country relies mainly in encouraging entrepreneurship and encouraging increased productivity by everybody in that economy, and of course investing in education and human capital in general, health care, and all that is necessary to have a people able to work and to work on increasing productivity.

INTERVIEWER: So the key role for the government in this modern era is just...

DOMINGO CAVALLO: No doubt the key role of the government is to provide security in every sense. Legal security, fiscal security—all that is very important. But investing in human capital

or facilitating the investment of the families in human capital, I think that is the best way to work for the expansion of the economy, and of course, the improving of the quality of life of every family in each country.

INTERVIEWER: And human capital?

DOMINGO CAVALLO: Is key, no doubt.

INTERVIEWER: And health care, education?

DOMINGO CAVALLO: Yes, it's the key, because nowadays fiscal capital is just a tool, but it is the ability of people to use fiscal capital and the ability to create and to invent and to develop new ideas and to implement them that moves the world.

2001: The Fall of Argentina's Government

INTERVIEWER: When you were called back into the government by de la Rúa ... were you aware of how difficult it would be?

DOMINGO CAVALLO: Yes, I was aware that it would be difficult, but I thought that implementing supply-side policies and at the same time working on government spending or reducing government spending, we could create more favorable expectations and prevent devaluation and a default or at least a combination of a devaluation and a default, on our debt.

I was wrong, because actually in the second semester of the year 2001 we lost credit, starting in the provinces, but also the federal government and in the capital markets. In the financial markets most of the people predicted that Argentina would eventually go in to a default and would be forced by the markets to devalue the currency, so I was struggling with that prediction during six consecutive months.

And, of course, as we did not get support in Congress for approval of the budget that was required for the IMF to continue disbursing their loans, that circumstance was used by some politicians—not only politicians from the opposition, but politicians from the same party of

President de la Rúa—to start destabilizing the government. But of course the public, the citizens were really angry because of the restrictions we had to impose in withdrawal of cash from the banks, and all that created this climate that generated the fall of the government.

INTERVIEWER: And it was your concern that what would happen, a run on the banks? What was your concern when you froze the banks?

DOMINGO CAVALLO: No, I was convinced that we had to complete the restructuring of our debt, which we had announced the first of November. And we did implement it for the domestic debt successfully. But we had to continue with an offering for external bond holders and external creditors in order to get significant reduction in the interest cost of our debt and to postpone amortization of the debt of the next few years in order to make it feasible to continue servicing the debt. But for the completion of this process of that restructuring we needed the support of the IMF, and that support was delayed as a consequence of the lack of approved budget, and it was in the middle of those negotiations with legislators that we had this social unrest and the riots and the government's fall.

INTERVIEWER: So [the social unrest was] all as a result of an economic crisis. Do you think it can get worse?

DOMINGO CAVALLO: It can get worse, particularly because the new government has defaulted on the debt and has devalued. But nobody knows what will be the new rules of the game for the future. I hope that when this program goes into television what I am saying now is not true anymore, because I expect that the new government [will] succeed in identifying and implementing a new set of rules which will preserve the climate of stability and will give the economy the vitality it needs for growing again. But right now, we are talking by the end of January of the year 2002. It is not clear that they will have identified those new rules of the game.

INTERVIEWER: Well, it seems to me very difficult. The world changes so rapidly. Isn't it difficult to write these new rules?

DOMINGO CAVALLO: You know, I think that in terms of Argentina, the basic new rules should be related to a fiscal system that incorporates the austerity that did not exist in this period I just described, '97, '98, [and] '99. That is a crucial part of the new rules of the game. Now, in terms of relations with other nations through trade or investment, it is clear that we have to preserve the rules of an open economy and try to continue eliminating distortions and facilitating trade and investment. Otherwise, there will be no room for growth in our economy.

INTERVIEWER: So the reason that people say that Chile is a successful example of this and Argentina is not, what you would say is the difference?

DOMINGO CAVALLO: I think the difference is that Chile was able to maintain fiscal discipline and Argentina was not. I think that is the big difference. Some people say the monetary regime of Chile was different from the monetary regime of Argentina; the monetary regime of Argentina was too rigid, too inflexible. I don't think that that is the difference, because we would have been even less disciplined in the fiscal arena if we had been more flexible in the monetary arena. And so it is not too much discipline that generated crisis in Argentina. On the contrary, it is, you know, the lack of fiscal discipline that generated the crisis.

Convertibility Vs. Dollarization in Argentina

INTERVIEWER: I believe Menem has called for dollarization as a critique of a peg to the dollar. Can you talk about that?

DOMINGO CAVALLO: Actually, Menem was convinced by the president of the Central Bank of those years, Pedro Pou, and also by the economic minister Roque Fernandez, that dollarization would be more the cause for dollarization. Actually, dollarization and convertibility are very similar monetary regimes. I thought that convertibility was better because it left the possibility of pegging the peso not only to the dollar, but to the dollar *and* the euro, for example, and that would have prevented the extreme appreciation of the peso during '99 and the year 2000 if the peg had been shifted to the dollar and the euro in '98 as I proposed at that time. But now I agree with the view that if one decides a strong peg, like the one that we had for 11 years in Argentina, maybe it's better just to use the foreign currency, the dollar, and that removes any expectation of devaluation.

Probably in the future, if Argentina needs again to adopt this kind of monetary regime, it will have to be dollarization rather than the convertibility as we had, because people will consider that convertibility failed, while very likely Argentines will see the dollar as a secure currency. Of course that is not inevitable. If there were enough fiscal discipline in Argentina in the next months and years, it would be possible to create credibility on the stability of the peso, of the local currency.

But I doubt that that will happen, because the reason why convertibility was abandoned is basically the need to print pesos to finance the deficit of the provinces and the federal government and, of course, if the government or the Central Bank prints pesos to finance deficits, the peso will not become a credible currency, and Argentines will try to use the dollar as they used already in the '80s and during all these years of convertibility, and eventually the only alternative open for Argentina to stabilize the economy will be full dollarization.

The Future Paths of Argentina and the Region

INTERVIEWER: Just two last questions. One is the sort of dark scenario of the future and one is your brighter vision. One, there's talk that this crisis in Argentina could even bring back a military ruler. Is that likely?

DOMINGO CAVALLO: No, not at all. No. I think it is clear that the citizens want a democratic government. Now, yes, people want also a renewal of political leaders. They consider that all those leaders that led the country in the last 17 years of democracy have failed, including me, of course. And they want new faces. I think that what we, the old politicians, should do is to work with our ideas, each one according to his own ideas, but help younger politicians to work for a better future for Argentina.

I don't think that it is democracy that has seen crisis in Argentina. It is mainly an economic crisis, which is convincing everybody that the old political style of Argentina, that using the money in the public sector to bribe the people, to pay benefits to certain groups, and not to take care of the basic obligations of the government, that is in crisis, but not democracy.

INTERVIEWER: So these provincial governments, and the issues there, will that be tackled in the future?

DOMINGO CAVALLO: Yes, I think so. Politicians will have no alternative but to start doing something to remove the vices of these governments, including the federal government. And then in future elections I think there will be new leaders and people will mainly choose those that will have these ideas that the citizens will consider appropriate.

I am optimistic in the medium and long term. Of course right now we are in a very deep crisis, but it's not a crisis of democracy; it's not a crisis of the market economy. It's a crisis of old politician styles which are not acceptable anymore for the population, and of many mistakes in economic policymaking.

INTERVIEWER: You spoke about the influence of Argentina's links to the global economy at the turn of the last century in the person who wrote the constitution. And do you have a vision for the Southern Latin American countries joined together? What is your vision for the future in how this region will participate more effectively in the global economy?

DOMINGO CAVALLO: I think that countries like Chile adopted the right approach. Chile is willing to integrate with Argentina, Brazil, and Mexico, but keeping the door open for using all the other alternatives in terms of having a more multilateral approach to trade and also to investment. I think that Latin America will go through this road that was opened by Chile. I don't think that Mercosur, [if it continues] as a sort of closed but larger space, will be the road. If Mercosur adopts a very open approach with respect to the rest of the world—that is, if, for example, the external tariff of Mercosur becomes closer to that of Chile—I think that Mercosur will have a future. Otherwise each one of the Latin American nations will try to get integrated into the world economy following a road like that of Chile.