financing operations via money issuance. The Argentine peso was pegged one-to-one with the U.S. dollar. While the Currency Board did help tame hyperinflation, other imbalances have developed over the subsequent years. The unemployment rate has been rising steadily, the government has relied on debt financing (which has in turn has led to a sharp rise in government and external debt), and the economy has lost its competitiveness in large part due to the strength of the U.S. dollar and the Brazilian devaluation. The Argentine authorities have yet to find a way to jump-start the economy and put the country's finances on a sustainable path.

The administration of former President Fernando de la Rúa devised various policies to energize the flagging economy, which has shrunk more than 10% since 1998. In particular, the government introduced competitiveness programs to provide tax and financing incentives to exporters and specific economic sectors (such as transportation, construction and agriculture). One of these measures involved the creation of an export peso (a hybrid of the U.S. dollar and the Euro, providing a subsidy to exporters). It also greatly altered the tariff structure originally shared with Brazil, Paraguay and Uruguay (the Mercosur Common External Tariff) by raising tariffs on consumer goods to 35% and lowering those on capital goods to zero. To stimulate consumption, the government also introduced a new bond (the "Lecop") to substitute for various previously issued provincial bonds that are valued nominally at par with the peso. Due to severe budget cuts at the provincial level, many provinces now pay both employees and contractors using these bonds.

Burdened with US$141 billion in debt (foreign and domestic), Argentina endeavoured to renegotiate with lenders (at much lower interest rates) to forestall a liquidity crunch. Having completed the first $50 billion phase of the swap with domestic banks, the government planned to swap approximately $20-25 billion in international debt (excluding the $35 billion borrowed from international institutions). At the same time, the International Monetary Fund (IMF) imposed strict conditions on Argentina for the release of any further monies, including controls over federal and provincial spending and the creation of a "zero deficit" policy (which saw public sector salaries and pensions cut 13%).

However, consistent difficulties in maintaining these spending limits, alongside tumbling tax revenues and industrial production, led to an unsustainable financial situation despite a US$48 billion IMF bailout package, a US$29.5 billion bond swap and the adoption of a new dollar-peso-euro peg. On January 3, 2002, Argentina formally defaulted on part of its US$141 billion debt when it missed a payment of US$28 million due on an Italian lira bond; it also suspended payment on its debt. Argentina is expected to maintain the announced sovereign debt moratorium on external financing obligations until a new agreement is reached with the IMF and international private creditors.

Recent Developments

On January 6, 2002, both houses of Congress approved a "public emergency and currency reform law" delegating extraordinary powers to the Eduardo Duhalde Administration until December 10, 2003 (Duhalde was appointed President by the Legislative Assembly on January 1, 2002). The main element of the new legislation is the end of the 10-year "convertibility" regime of the one-on-one peso-dollar peg. The new legislation gives the President sweeping "emergency powers," including power to devalue the peso. The Executive has the power to design and regulate any new currency regime(s).

A dual exchange rate regime has been adopted. For most financial transactions (e.g. import and export transactions), the exchange rate is fixed at 1.4 pesos per U.S. dollar (an implied currency devaluation of 28.6%), while for other transactions (e.g. those of tourists and ordinary Argentines) the peso will float freely. The government has indicated that it wants to move to a single, floating exchange rate over the course of the next few months. The maintenance of the fixed exchange rate is seen as a government attempt to manage a transition toward a comprehensive free-floating currency regime. The central bank will be authorized to buy and sell foreign currency with its own reserves in order to maintain the official rate, as well as print pesos. The government still intends to tie the peso to a basket of currencies (e.g. the dollar, euro and real). It also intends to implement a host of parallel measures aimed at controlling the impact of this drastic move among the economic actors and the disenchanted and nervous Argentines.

The key issue is not the devaluation rate, but rather the ability of the new currency regime to generate local confidence, reverse capital flight and resume a trend of