Loyola of Los Angeles International and Comparative Law Review

Volume 24 | Number 3 Article 4

6-1-2002

Fiscal Policies as Decisive Solutions for Troubled Economies: Differing Legislative Enactments in Argentina and Ecuador

Caroline R. Hurtado

FISCAL POLICIES AS DECISIVE SOLUTIONS FOR TROUBLED ECONOMIES: DIFFERING LEGISLATIVE ENACTMENTS IN ARGENTINA AND ECUADOR

I. INTRODUCTION

"The country of melancholy tangos" now more than ever describes the once prosperous nation of Argentina.[1] Argentine cities were once saturated with European imports and filled with lives of excess.[2] These same cities are now experiencing the sobering effects of empty shopping centers,[3] a one in five unemployment rate, and banks unable to collect on their loans.[4] Today, Argentina embodies the poignant irony of what was once a harmless nickname.[5]

Diagnosing the causes of Argentina's economic ailments involves determining whether Argentina succumbed to the "historical impediment" plaguing Latin American countries, namely, " [t]he centralization of political and economic power. . . corruption, inequality under the law, and [gross] misallocation of resources."[6] Economists struggle with the realities of a nation of plenty now finding itself with nearly half a million people buying food and clothes in barter clubs,[7] coupled with rising political and social unrest.[8] Ascertaining why and how this happened is as important as finding a solution.

Argentina's devastating economic condition requires fiscal as well as institutional reform. In undertaking fiscal reform, a nation

---

1. *See* Clifford Krauss, *Economy's Dive Dazes Once Giddy Argentina,* N.Y. TIMES, Sept. 30, 2001, at A3.

2. *See* John Barham, *Learning the Hard Way; Argentina's Depression,* LATINFINANCE, Sept. 1, 2001, at 25.

3. *Id.*

4. Krauss, *supra* note 1, at A3.

5. *See id.*

6. FOUNDATION FRANCISCO MARROQUIN, *FFM Guided Ecuador Toward Dollarization; Now Charred Sucres Signal an Earnest Intent,* Quarterly Report, First Quarter 2000.

7. Krauss, *supra* note 1 at A3.

8. *Id.*

may opt to restructure or devalue its economy, tie its economy to the U.S. dollar [hereinafter dollar] by way of a currency board system,[9]or even reject its national currency in exchange for financial stability in a process known as dollarization.[10] Legislative enactments used in changing a country's currency vary according to its current political, economic and social climate.[11]

Although dollarization and currency boards are criticized as drastic measures that dissipate economic sovereignty, the economic prosperity they can achieve makes them a desirable alternative.[12] Dollarization, for example, is seen as a necessary measure to quell inflation, reinstate economic stability and ultimately restore confidence in a nation's fiscal policies.[13] Due to the radical and irreversible nature of the process, however, dollarization is analogized as being "tantamount to zealous dieting, [effectively] trying to lose weight by wiring your jaw shut."[14]

Using Ecuador as a model, this comment discusses the success of legislation that ties a nation's currency to the dollar by way of full dollarization. It next analyzes the implementation of a currency board system in Argentina. Part II explains the dollarization process, the use of treaties and unilateral implementation methods, and discusses when nations should dollarize. Part III examines dollarization as applied to Ecuador, the most recent example of a dollarizing country. Part IV discusses convertibility legislation, which implemented a currency board system in Argentina. Part V concludes that Argentina's prospects for financial success are dependent on its willingness to change well-established fiscal policies.

---

9. A currency board ties the domestic currency to the foreign currency at a fixed rate by using reserves in the chosen foreign currency. Rogerio Studart, *Dollarization: "An Intellectual Fad or a Deep Insight"?*, J. OF POST KEYNESIAN ECON., Summer 2001, at 639, 645-646. This results in stronger and more credible monetary policies where the strength of the domestic currency is in question. *See id.*

10. *See* Stephen A. Meyer, *Dollarization: An Introduction*, *at* http://interdependence.org/pages/smeyer_viewer.html (last visited Feb. 21, 2002).

11. *See id.*

12. *See* Gumisai Mutume, *Finance: Gunning For The United States Of Latin America*, INTER PRESS SERV., Oct. 6, 2000.

13. Hale E. Sheppard, *Dollarization of Ecuador: Sound Policy Dictates U.S. Assistance to this Economic Guinea Pig of Latin America*, 11 IND. INT'L & COMP. L. REV. 79, 91 (2000).

14. *Id.* at 91.

II. BACKGROUND: AN OVERVIEW OF THE DOLLARIZATION PROCESS

Dollarization is essentially a renunciation of a country's local currency in exchange for the U.S. dollar as its official legal tender.[15] It has an array of implementation methods, ranging from unofficial to official dollarization, and often involves treaty negotiations to strengthen a plan.[16] A country's commitment to economic sovereignty, balanced against its desire to exchange independence for reprieve from overwhelming conditions, are the essential elements considered when deciding if and how to proceed with the process.[17]

A. Traditional Dollarization Methods

Dollarization is accomplished through unofficial, semi-official and full dollarization models.[18]

1. Unofficial Dollarization

Unofficial dollarization is a gradual process that allows citizens to maintain a share of financial wealth in dollars, absent a formal government policy.[19] Shifts in economic stability, however, expedite the process and motivate residents to use the dollar instead of their country's currency.[20] On a functional level, the local currency remains the legal tender, while the dollar is reserved for use in private banking and contracting.[21]

The effects of unofficial dollarization are uncertainty and excess demand for foreign currency, predominantly in the context of business transactions.[22] The excess demand for foreign currency causes devaluation of the exchange rate, which in turn promotes inflation.[23] In response to these negative repercussions, governments without significant international currency reserves

---

15. Meyer, *supra* note 10.
16. *Id.*
17. *See id.*
18. Sheppard, *supra* note 13, at 81-82.
19. *Id.* at 82.
20. *Id.*
21. Meyer, *supra* note 10.
22. Studart, *supra* note 9, at 642. *See also* Meyer, *supra* note 10 (unofficial dollarization and spontaneous dollarization are used interchangeably by different authors although they refer to the same concept).
23. Studart, *supra* note 9, at 642.

are forced to devalue their own currencies and reverse the unofficial dollarization in a process known as "de-dollarization."[24]

While the consequences of unofficial de-dollarization are serious, they pale in comparison to the results of a failed full dollarization plan.[25] Arguably, the permanent nature of full dollarization makes it the most effective method of providing macroeconomic[26] stability.[27] Moreover, faced with crippling factors such as high inflation and currency devaluation, investors and average citizens alike prefer dollars and dollar-denominated assets over their own unstable local currency.[28] Furthermore, businesses and governments prefer to contract in dollars, as it facilitates conducting business where inflation is high and variable.[29] This is due in part to the need for certainty when executing international business transactions.

2. Semi-official Dollarization

Semi-official dollarization is the same as unofficial dollarization[30] except there is legal recognition of two currencies circulating concurrently.[31] As in the unofficial model, the local currency is reserved for daily transactions while the dollar is preferred for high value business transactions requiring more certainty.[32] Here, as with unofficial dollarization, countries retain the freedom to conduct their own monetary policies in addition to preserving their central bank, absent a bilateral agreement.[33]

3. Full Dollarization

Full dollarization is a pervasive and irreversible measure. The goal of official dollarization is integration into large financial

---

24. *Id.*
25. *Id.*
26. "Macroeconomics: The study of the behavior of the economy as a whole. The economy is disaggregated into what are believed to be broadly homogeneous categories and the determinants of the behavior of each of these aggregates is integrated to provide a model of the whole economy." THE MIT DICTIONARY OF MODERN ECONOMICS (4th ed. 1999).
27. Studart, *supra* note 9, at 643.
28. Meyer, *supra* note 10.
29. *Id.*
30. *See id.*
31. Sheppard, *supra* note 13, at 82.
32. *See id.*
33. *Id.*

markets; adding legitimacy to a once defunct financial system.[34] A fully dollarized country, therefore, gives up its independent monetary policy.[35] It renounces its currency and must abolish its central bank.[36] These actions encourage foreign financial institutions to conduct business transactions in the dollarized country because the value of transactions is familiar and stable.[37]

Fully dollarized monetary systems, however, have some limitations.[38] An officially dollarized country cannot unilaterally devalue its currency and is less able to respond to economic shocks.[39] It must adopt alternative methods to ease expected financial changes, such as "(1) fostering flows of capital into or out of the country to offset the shock; (2) reducing the government budget; and (3) increasing prices and lowering wages."[40] A strong legislative body is essential to promulgate laws that go beyond currency devaluation, focusing instead on practical matters affecting day-to-day life.[41] Such matters include securing the bank deposits of average citizens so that they may confidently withdraw funds without worrying about their bank's solvency, internationalizing banking practices, and entering into bilateral agreements with international organizations.

B. Bilateral and Unilateral Agreements

Bilateral and unilateral agreements are instrumental to facilitate the dollarization process and ensure its success.[42] Bilateral agreements are formal contracts with the United States, addressing such matters as macroeconomic policies, seigniorage sharing,[43] and combined monetary and financial regulation.[44] They

---

34. *Id.* at 83.
35. *Id.*
36. *Id.*
37. *Id.*
38. *See id.*
39. *Id.* at 84.
40. *Id.*
41. *See id.*
42. *See* Meyer, *supra* note 10.
43. Seigniorage sharing, or the profit earned when central banks print their own currency, is one consideration for discussion between a dollarizing country and the United States. Steve H. Hanke, ***Indonesia Stands at the Abyss—again***, NAT. POST (Can.), July 7, 2000, at C15. On July 13, 2000, the U.S. Senate Banking Committee debated a dollarization bill (the International Monetary Stability Act) in which the United States would share excess profits generated by printing dollars in countries adopting the dollar. *Id.* Implementation of the International Monetary Stability Act would signal U.S. support

are used to facilitate the political consensus necessary to dollarize.[45] Policy makers often see a monetary treaty as a safety net in the event the local economy fails.[46] Nevertheless, dollarization is typically implemented as a desperate measure to resuscitate a failing economy, leaving no time to negotiate bilateral agreements.[47]

Notwithstanding a bilateral agreement's tendency to garner political consensus, "economic gains can occur even if a country dollarizes unilaterally, if it can put in place the economic policies needed to sustain dollarization."[48] Therefore, a country may opt for a unilateral agreement to develop the policies necessary to sustain a new monetary scheme, absent an agreement with the United States, assuming full responsibility to assess the competency of their course of action.[49] The tumultuous conditions leading to a decision to dollarize, however, ultimately compromise the integrity of a unilateral agreement.[50] Nonetheless, if a country opts to dollarize unilaterally, it is ultimately responsible to decide if dollarization is the appropriate policy to pursue.[51] This decision is made in light of each country's own economic and political circumstances and they accordingly assume the risk of failure.[52]

C. When Should a Country Dollarize?

The test to determine whether a country should abandon its economic sovereignty by adopting another country's currency is not dispositive. Economists traditionally asserted that dollarization would only succeed in smaller Central American countries.[53] With the advent of currency crises from Mexico to Asia, however,

---

for bilateral dollarization agreements, particularly with regard to seigniorage and its potential profits. *Id.*

44. *See* Studart, *supra* note 9 at 641.

45. IMF Economic Forum, *Dollarization: Fad or Future for Latin America* (June 24, 1999), *at* http://www.imf.org/external/np/tr/1999/tr990624.htm.

46. *Id.*

47. Meyer, *supra* note 10.

48. *Id.*

49. *Id.*

50. *See id.*

51. *See* Edwin M. Truman, Treasury Assistant Secretary for International Affairs, Testimony Before the Senate Banking Committee Subcommittee on Economic Policy, Treasury News (Feb. 8, 2000), *at* http://www.ustreas.gov.press/releases/ps377.htm.

52. *Id.*

53. *See* Studart, *supra* note 9, at 645.

dollarization, currency boards,[54] and other stabilizing mechanisms provide reprieve in the midst of severe currency or monetary crises.[55]

As demonstrated by the Ecuadorian economy's positive experience with dollarization, a successful dollarization program operates under the following model. First, it needs a legislative body that can garner the requisite consensus to quickly pass laws.[56] These laws set forth necessary bank and spending reforms consistent with those in the international community.[57] A foreign investor is likely to invest in a country with strong and familiar fiscal policies.[58] Investments of this type are vital to a country in a severe fiscal crisis.[59]

It is important to assess why a country[60] sacrifices monetary sovereignty for the sake of stability.[61] Some determinants are: "past history of hyperinflation, [a]bsence of credible stable government institutions, [extensive] exposure to nervous international investors, availability of reserves, [s]trength of the banking system, and existence of rule of law, [specifically] in the case of a Currency Board."[62] When faced with these factors, fear of gross monetary instability urges drastic change.[63]

In addition to these political factors, success of a political regime is directly linked to the country's financial stability.[64] For example, in 1983, the Israeli finance minister was forced to resign as a direct result of public outrage over the possibility of dollarization.[65] Similarly, former Ecuadorian President Mahuad's decision to dollarize resulted in a military coup that ended his

---

54. Hong Kong and Argentina are cited as the most prominent examples of the use of currency boards. Francois R. Velde & Marcelo Veracierto, *Dollarization in Argentina*, ECON. PERSPECTIVES, 1st Quarter 2000, at 24.

55. *See* Studart, *supra* note 9, at 651.

56. *See infra* Part III.A–B.

57. *Id.*

58. *Id.*

59. *Id.*

60. In Ecuador, the "impeding social crisis [of the past], generated by overdrawn bank accounts and the lack of political consensus was forestalled by military intervention." AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH: THE ECUADORIAN DISEASE. In fact, for much of the twentieth century Ecuador (along with Bolivia) was among the most coup-prone South American states." *Id.*

61. IMF Economic Forum, *supra* note 45.

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

presidency.[66] These examples illustrate the serious potential consequences of a country's decision to dollarize.[67] Consequently, a government's political[68] decision to dollarize cannot replace strong macroeconomic policies, institutions and open markets.[69]

D. Cost/Benefit Analysis

Dollarization does not come without costs. Critics argue that while waiting to reap the long-term benefits of dollarization, governments are left with one less tool to protect their countries from external economic shocks, such as a recession in the United States.[70] They argue this makes countries dependent on the U.S. monetary system.[71] In addition, the rigidity of full dollarization legislation diminishes a country's ability to respond to these external shocks.[72] Further, a country tied to the U.S. dollar is not only vulnerable in the event of a recession in the United States,[73] but also to changes in international trading relationships.[74] Nonetheless, proponents argue "eliminating the internal risk of devaluation far outweighs the threat from external shocks."[75] Essentially, protecting one's economy from a recession is more important than speculating about one in another country.[76]

The decision to dollarize in Latin American countries is characterized both as a final attempt to "nail down a series of reforms to fiscal policy, the banking system, and labor markets,"

---

66. Sheppard, *supra* note 13, at 88.

67. *See id.*

68. *See* Kenneth Maxwell, *Avoiding the Imperial Temptation: The United States and Latin America; Economic and Political Relationship*, WORLD POLICY J., Sept. 22, 1999 (discussing the sensitivity of Latin Americans to depletion of sovereignty and a relationship with the United States). The sensitivity of Latin Americans is an important determinant, particularly in a politically volatile environment where popular sentiment is of paramount importance).

69. Truman, *supra* note 51.

70. *Wagering on the Dollar*, LATINFINANCE, Sept. 2000, at VII. *See also* Stephen Stephen Fidler, *Dollarisation 'not a quick fix'*, FIN. TIMES (LONDON), Jan. 28, 1999, at 8.

71. *Id.*

72. *See* Manuel Pastor & Carol Wise, *From Poster Child to Basket Case*, FOREIGN AFFAIRS, Nov. - Dec. 2001, at 2.

73. Kintto Lucas, *Economy-Latam: FTAA Is a Threat, Warns Nobel Laureate*, Oct. 26, 2001 (noting that changes in the international economy could dissipate financial growth in countries tied to the dollar, ultimately leading to their inability to compete in global markets).

74. *Id.*

75. *Wagering on the Dollar*, *supra* note 70.

76. *See id.*

and as a "first-step shock treatment to force fiscal and banking sector reform."[77] Whether the policy is initiated as a first or last step that is not important. Rather, success depends on whether a country has the political and legislative consensus to successfully implement dollarization.[78] To predict the potential success of the plan, one must consider strengthening the banking system, increasing flexibility of labor markets and reducing budget deficits.[79]

III. ECUADOR TESTS DOLLARIZATION

An effective discussion of dollarization necessitates analysis of the Ecuadorian economy, the most contemporary example of a country dollarizing unilaterally.[80] On September 9, 2000, Ecuador became the largest independent country to officially adopt the dollar, replacing its original currency, the *sucre*.[81] When the value of the *sucre* decreased sixty-four percent in 1999, and again plunged twenty-four percent in the first week of January 2000,[82] Ecuadorians faced one of the worst economic crises[83] in their country's history, a situation that mandated drastic measures. While dollarization was reported as a radical and novel response to the crisis, there were indicators that Ecuador began the dollarization process long before President Noboa formally unveiled the plan[84] on January 9, 2000.[85]

---

77. Meyer, *supra* note 10.

78. *Id.*

79. *Id.*

80. Adoption of the U.S. dollar by Ecuador's thirteen million people could perpetuate use of the dollar throughout Latin America, strengthening the potency of the U.S. dollar as a world currency. Sheppard, *supra* note 13, at 112-113. "Ecuador now constitutes a test case which, if successful, [w]ill serve as an invaluable instrument for the propagation of dollarization throughout the region." *Wagering on the Dollar, supra* note 70. Conversely, if this test case should fail, it would undoubtedly damage the policy's credibility throughout the region, if not the world. Sheppard, *supra* note 13, at 112-113.

81. Mutume, *supra* note 12.

82. *Wagering on the Dollar, supra* note 70. Fear of hyperinflation was an additional economic factor leading to Ecuador's decision to dollarize. *Id.*

83. *Ecuador's Government Highlights Dollarization*, XINHUA NEWS AGENCY, Feb. 23, 2000, LEXIS, News Library, Xinhua File.

84. On March 9th, 2000, President Noboa signed a bill formally adopting the dollar as the national currency. Mark Falcoff, The Ecuadorian Disease, American Enterprise Institute for Public Policy Research, LATIN AMERICAN OUTLOOK, Oct. 2000.

85. Specifically, by January 1999, sixty-two percent of loans, and fourty percent of deposits were transacted in U.S. dollars; by the end of 1999, devaluation, fueled by the population's growing preference for dollars kept at home in 'mattress banks' was spiraling out of control. *Wagering on the Dollar, supra* note 70. Thus, it is not surprising that by the

A. Legislation

In March 2000, Ecuador's National Congress enacted the Fundamental Law for Economic Transformation[86] officially changing the Ecuadorian currency from *sucres* to dollars,[87] and ushering in a monetary transformation system.[88] Although pervasive in its effect on social and economic policies alike, the Fundamental Law for Economic Transformation, an operative provision of the Trolley Bus legislation, passed without requiring a constitutional amendment, because the *sucre* was still available for smaller purchases.[89] Miguel Davila, general manager of Ecuador's Central Bank stated, "the law[s] [would] be complemented by other changes, including privatization, new airports and road infrastructure, greater labor flexibility, social security reforms and an overhaul of the tax system."[90] A pivotal step in implementing dollarization, not mentioned by Mr. Davila, however, was the government's decision to eliminate the Central Bank's ability to create currency.[91] In fact, banking reform laws dominate dollarization legislation in Ecuador.[92]

According to Jorge Guzman, Ecuador's Finance Minister, the new laws were directed at getting the attention of the international community and bolstering investments in Ecuador.[93] Ecuador's willingness to change domestic economic policy, the government reasoned, would lead to bilateral agreements, particularly with the

---

time Ecuador's National Congress passed the dollarization legislation, approximately eighty percent of loans, and roughly sixty-five percent of all deposits effectuated in Ecuadorian banks were denominated in U.S. dollars. *Id.*

86. *Ecuador's Government Highlights Dollarization*, XINHUA NEWS AGENCY, *supra* note 83.

87. *Ecuador Approves Dollarization*, XINHUA NEWS AGENCY, March 1, 2000, LEXIS, News Library, Xinhua File.

88. Lic. Josemaria Bustamante, *Ecuador's Economic Transformation Law*, *at* http://www.bomchilgroup.org/ecudec00.html (last visited Feb. 21, 2002).

89. Ecuador's economic reform legislation is commonly known as "Trolley Bus Legislation". Stanley Fischer, Managing Director, IMF Conference Sponsored by Council of the Americas, *State Department Briefing*, FED. NEWS SERV., May 1, 2000. Nicholas Moss, *Getting to Know You; Ecuador's Move to Dollarization is Helping its Economy, but its also Creating Confusion and Controversy*, LATIN TRADE, Sept. 2000, at 28.

90. *Id.*

91. Sheppard, *supra* note 13, at 90-91.

92. *Fine-tuning the Financial Framework, Citibank Latin Banking Guide & Directory 2001 Supplement*, LATINFINANCE, Aug. 2001, at 34.

93. *Ecuador Approves Dollarization*, *supra* note 87.

International Monetary Fund (IMF).[94] Such bilateral agreements would bolster the legitimacy of Ecuador's dollarization plan. Encouraging these agreements showed Ecuador's willingness to accept the IMF's help, while at the same time creating long-term unilateral policies that would prevent dependence on future IMF bailouts.[95]

Historically, Ecuador was ineligible for much needed IMF funding because of its inability to implement policies necessary to sustain an IMF program.[96] The IMF conditions its lending on a debtor country's commitment to internal and external debt restructuring, particularly in the private sector.[97] The Ecuadorian government borrows substantially from private sector entities such as corporations.[98] Ecuador's pattern of default on private sector loans and failure to implement policies to avoid default caused the IMF to shy away from becoming another one of Ecuador's unpaid creditors.[99] As a result, to bolster the IMF's confidence in Ecuador's solvency, bank reform legislation became imperative.

Ecuador's bank reform legislation demonstrated the country's commitment to address its debt while becoming fiscally responsible to eliminate their need for future outside assistance.[100] IMF programs, however, are just one of many debt restructuring programs, and it is likely that other operative provisions of the Trolley Bus legislation will instigate necessary policies to address debt issues.[101]

Instrumental to Ecuador's dollarization plan was the passage of The Economic Transformation Law and Investment Promotion and Civil Participation Laws.[102] These banking reform laws support the proposition that adopting the dollar requires uniformity not only in civil laws, which affect the consumer and labor markets, but also finance laws that affect banking.

---

94. *Id.* "International Monetary Fund:. . .The purposes of the fund are to encourage international monetary co-operation, facilitate the expansion and balanced growth of International Trade, assist member countries in correcting balance of payments deficits and promote foreign exchange stability." THE MIT DICTIONARY OF MODERN ECONOMICS (4th ed. 1999).

95. *Ecuador Approves Dollarization, supra* note 87.

96. Fischer, *supra* note 89.

97. *See id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Fine-tuning the Financial Framework, supra* note 92, at 7.

102. *Id.*

Primarily, these laws set the legal and operational framework for bank restructuring.[103] They specify measures to strengthen the solvency of banks using international practices; facilitate the restructuring of past due loans held by private borrowers; develop measures to enforce the banks' liquidity management; establish specific procedures for resolving closed banks; and include guidelines to strengthen regulation, supervision and transparency.[104] These measures, if successful, would usher in a stronger economy, ultimately reinforcing the legitimacy of the laws.

Cleary the goal of these laws is to make Ecuadorian banks conform to international banking practices. In addition to revamping accounting standards and increasing accountability to creditors, the newly restructured banks are also required to phase out their deposit guarantees.[105] Such an act would allow banks to use discretion with regard to investments and cash flow allocation, ultimately instilling confidence in prospective investors.

It is counterintuitive to propose that citizens would have confidence in a banking system that phases out bank guarantees, particularly when bank guarantees act to secure investments. This quandary is evident in provisions of the Economic Transformation Law.[106] Specifically, full coverage deposit guarantees are replaced by limited coverage guarantees, and deposits once held in closed banks are transferred to open banks instead of being paid out in cash.[107] This restraint on personal funds leads to further distrust of a faltering banking system, as opposed to fostering support in a new system backed by the U.S. dollar.

Consumer mistrust of Ecuador's currency and banking system was evident before talks of dollarization began.[108] Billions of U.S. dollars left the Ecuadorian banking system for people's mattresses or foreign bank accounts.[109] Public mistrust, however, is overshadowed by tacit support of dollarization from the IMF, as well as notable increases in bank deposits, which are preliminary indicators of the reform's efficiency.[110]

---

103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Wagering on the Dollar, supra* note 70.
109. *Id.*
110. *See Ecuador: Back from the Brink*, LATINFINANCE, Sept. 2000.

B. Regulatory Bodies and Their Role in Promoting Economic Stability

Of paramount significance to a country implementing a new economic plan is their willingness to assent to the conditions of prospective lending agencies. Pursuant to these conditions, a country will legislate or alter well-established financial practices. The Ecuadorian Superintendency of Banks is a regulatory body that ensures domestic banking regulations comply with international practices.[111] The Superintendency's jurisdiction is far reaching, affecting even Ecuadorian offshore banking operations that do not comply with the practices instituted as policy.[112] Dissolution is a drastic measure used to discipline noncompliant offshore banks.[113] To bolster its jurisdiction, a strengthening program for the Superintendency is under development.[114] This program includes improving accountability of banks to their creditors, requiring them to publish financial statements on a quarterly basis and amending accounting standards for financial institutions to ensure conformity with international practices.[115]

As previously noted, the effects of dollarization are not always immediate, particularly because it takes time to successfully employ the requisite policies pursuant to economic laws. The dollarization process began in Ecuador in January 2000, when the government first announced and initiated the laws necessary to implement the process.[116] It wasn't until June 8, 2001 that the *sucre* gave way to the dollar in the final stage of Ecuador's dollarization scheme.[117]

The year and a half between the announcement of the plan and the final stage was tumultuous.[118] The public partly attributed its discontent with the government to the involvement of international financial institutions.[119] "Thousands of indigenous Ecuadorians from across the country descended in Quito [the

---

111. *Fine-tuning the Financial Framework*, *supra* note 92, at 3.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Ecuador's National Currency Makes Way for the Dollar,* AGENCE FRANCE PRESSE, June 9, 2001.

117. *Id.*

118. *See* Gumisai Mutume, *Finance—Ecuador: Adjustment Measures Must Go, Say NGOS,* INTER PRESS SER., Feb. 2, 2001.

119. *Id.*

nation's capital] to demonstrate against recent government-mandated price increases as part of economic reforms" promulgated by the IMF and World Bank.[120] It was argued that these dollarization-related economic reforms increased poverty among the country's indigenous people.[121] Conversely, Ecuador's low productivity in light of its population base is cited as the principal contributor to the nation's poverty.[122] While President Noboa currently enjoys the support of the international community, he fears that the country will return to the social unrest and instability that propelled the ouster of former President Mahuad, and ultimately jeopardize his own chances for reelection.[123]

To obtain relief from what has been called "the dollarization straightjacket," the Ecuadorian government adopted a series of value added tax (VAT) increases, which were vehemently opposed by the general population, in exchange for a $304 million stand-by agreement with the IMF.[124] The World Bank also provided $150 million for social and infrastructure projects.[125] The validity of these mandatory VAT increases is currently under scrutiny by the Ecuadorian Constitutional tribunal .[126]

Ecuador is in a proverbial "catch 22." [127] It must assent to conditions imposed by international organizations to receive desperately needed funding, yet those very conditions tend to undermine social stability.[128] The VAT taxes and other structural adjustment programs supported by the IMF and World Bank will most notably impact the "small and medium-sized businesses that employ the majority of the people."[129] This is potentially most threatening to social stability, as many of these businesses have

---

120. *Id.*

121. *Id.*

122. Interview by Norma Dominguez with Pablo Lucio Paredes, former Secretary General of Planning of Ecuador, *at* http://nuevamayoria.com/english/entrevistas/notas/iparedes300801.htm (Aug. 30, 2001).

123. *Ecuador: Most Likely Regime Scenario,* THE PRS GROUP/ POLITICAL RISK SERVICES, July, 1, 2001.

124. *Id.*

125. *Id.*

126. *Most Likely Regime Scenario, supra* note 123.

127. *See* Mutume, *Finance—Ecuador Adjustment Measures Must Go, Say NGOS, supra* note 118.

128. *Id.*

129. *Id.*

vowed to ignore the taxes and resort to civil disobedience if necessary.[130]

The validity of the IMF structural adjustment programs (SAPS) in Ecuador should be assessed.[131] It is difficult to distinguish the negative consequences of failed SAPS from the effect of globalization.[132] A report by the Structural Adjustment Participatory Review Initiative (SAPRI)[133] indicates the consequences of SAPS have been dismal.[134] Specifically, between 1993 and 1995, "more than 2,800 firms went out of business."[135] Preliminary reports indicated that policies originally proffered to promote labor market flexibility instead perpetuated unemployment from six to 14.4 percent.[136] The SPRI's research culminated in a letter to World Bank President James Wolfensohn, detailing concerns that the policies offered by international financial institutions "are forcing people onto the streets in protest and that the government['s] response has been repression."[137] Despite the public's disdain for the effects of fiscal reforms, the IMF continues to be generous in light of Ecuador's history of default on bonds and loans, and IMF support has undoubtedly contributed to the success of dollarization in Ecuador.[138]

Preliminary economic indicators reflect support for Ecuador's dollarization plan by the international community.[139] The plan has not been in vain as it has successfully ushered in a new era of economic prosperity.[140] Two significant factors signaling a successful turnaround in Ecuador's economy are a prospective twenty-six percent cut in inflation and 3.8 percent annual growth

---

130. *Most Likely Regime Scenario, supra* note 123.

131. Mutume, *Finance—Ecuador Adjustment Measures Must Go, Say NGOS, supra* note 118.

132. *Id.*

133. The SAPRI is a tripartite oversight committee "involving civil society, governments and the World Bank" with the purpose of reviewing structural adjustment programs. Mutume, *Finance—Ecuador Adjustment Measures Must Go, Say NGOS, supra* note 118.

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. Sheppard, *supra* note 13, at 85. The IMF and other key international financial institutions vowed to provide $2 billion in loan support for Ecuador's dollarization plan. *Id.*

139. *Most Likely Regime Scenario, supra* note 123.

140. *Id.*

over the 2001-2006 forecast period.[141] The foregoing confirms that successful dollarization requires a political system comprised of a strong legislative body adept at developing laws that reform and reverse a history of inefficient policies, thus creating a strong banking system with internationalized practices, bolstered by support from international agencies.[142]

IV. SOLUTIONS FOR ARGENTINA

Inflexible laws, insufficient labor reform policies, and excessive susceptibility to regional financial turmoil exacerbated financial distress in Argentina.[143] To address these issues, Argentina must consider implementing dollarization policies as a solution, especially in light of the success of dollarization in Ecuador.

In an attempt to quell staggering inflation rates, Argentina denominated its peso to the dollar in 1991.[144] This action marked the end of hyperinflation that plagued the economy from 1983-1989.[145] Under this new peso valuation model, also known as the Currency Board[146] or Peso-Dollar Peg, each Argentine peso is backed by one U.S. dollar in Argentina's national treasury reserves.[147]

Today, Argentina is in danger of defaulting on its $130 billion debt and falling into a national depression.[148] In light of these recent events, Argentina desperately needs to change fiscal

---

141. *Id.*

142. *See infra* Part III.A–B.

143. *See infra* Part IV.B.

144. In March 1991, The Argentine Congress established the convertibility of the austral, which had been the currency in Argentina since 1985, to the U.S. dollar at a rate of 10,000 austral per dollar. Velde & Veracierto, *supra* note 54, at 25. The peso later replaced the austral in 1992, at a rate of 1 peso for 10,000 australes. *Id.*

145. Marcela Valente, Economy—Argentina: *Anxious Gov't Contemplates Dollarization*, INTER PRESS SERV., Oct. 4, 2001.

146. In implementing the currency board arrangement, the Argentine government reduced spending, taxes and eliminated the deficit. Velde & Veracierto, *supra* note 54, at 26. Additionally, it privatized many state-owned companies and carried out other reforms, including trade liberalization, freeing international capital flows, as well as deregulation of the banking industry. *Id.*

147. Valente, *supra* note 145. Pegged currency rates are deemed more appropriate for developing countries than floating rates. *See, e.g.*, Steve H. Hanke, *Symposium: The Derivatives and Risk Management Symposium on Stability in World Financial Markets: Reflections on Exchange Rates and Dollarization*, 4 FORDHAM FIN. SEC. & TAX L.F. 63, 68 (1999).

148. Barham, *supra* note 2.

policies in order to stabilize its economy. Dollarization and devaluation are the most practical options for change.[149] The recent devaluation of the Argentine peso does not diminish the viability of dollarization as an option for economic reform.[150] It currently fixes the peso at a rate of 1.4 pesos to the dollar for export and import transactions, leaving a floating rate[151] for day-to-day transactions. Consequently, the peso is at the mercy of the market because its value can change at the first sign of an economic downturn.[152]

To influence the future of Argentina's economy, it is imperative to analyze prior legislative enactments and ascertain their shortcomings or merits. The passing of convertibility legislation marked the official beginning of Argentina's relationship with the dollar.[153] Proponents of convertibility legislation argue that dollarizing would leave Argentina without fiscal or monetary control, ultimately damaging its credibility in the international community.[154] The short-lived success of convertibility, however, coupled with comparison to the Ecuadorian model, suggest that dollarization is a better alternative for Argentina.

A. *Argentina Introduces Convertibility Legislation*

In 1991 the Argentine National Congress passed the Convertibility Law, fixing the exchange rate of the Argentine Peso to one peso per U.S. dollar.[155] The Convertibility Law known as "Ley Civil 2459," said that, "[t]he peso shall be compatible with

---

149. *See* Stephen Wisnefski, *Argentine Dollarization Talk Gets More Serious Attention*, DOW JONES NEWSWIRES, Oct. 18, 2001.

150. *See* Associated Press, *Argentine Chief Appeals to Business*, N.Y. TIMES, *at* http://nytimes.com/aponline/international/AP-Argentina.html (Jan. 7, 2002).

151. A floating rate is subject to market forces and is not necessarily tied to another country's currency. Hanke, *supra* note 147, at 68. A pegged rate, on the other hand, is comprised of foreign and domestic components. *Id.* The affect of being tied to another currency leaves a country's domestic policies vulnerable any economic changes in that tying country and brings to light discrepancies between the fixed exchange rate and monetary policies, ultimately leading to devaluation. *Id.*

152. *See id.*

153. Paul Keenan, *The 1998 Argentine Labor Reform Act: A Perpetuation of the "Incoherent State"?*, 54 U. MIAMI L. REV. 125, 129 (1999).

154. Marc Minikes & John Foyt, Comment, *Argentina: Austerity Measures & Capital Flows: Will the Peso Peg Be Held?*, 1 UCLA J. Int'l & For. Aff. 431, 444 (1996).

155. Keenan, *supra* note 153, at 129.

the United States dollar, in a ratio of one dollar to one peso, for sale, in the conditions established by Ley Civil number 23928."[156]

Civil code 23928 set forth the conditions under which the Argentine economy would function in light of its new relationship with the U.S. dollar.[157] The Convertibility legislation successfully stabilized the "Argentine currency and inflation rate by providing full foreign exchange backing of the monetary base."[158] The essence of the legislation was not only that the peso was linked to U.S. dollar, but that the Convertibility Board also held reserves of foreign currency in proportion to the Argentine money supply.[159] Furthermore, the government relinquished control of monetary policy,[160] resulting in its inability to print money to close gaps in the budget as it previously had done, thereby losing the profit typically gained when a country prints its own currency.[161] Argentina demonstrated its commitment to fiscal and monetary reform by requiring its domestic currency to be fully backed by foreign currency reserves and by maintaining a fixed exchange rate with the U.S. dollar.[162] Argentina's current situation, however, casts suspicion on whether these reforms were pervasive enough to combat the dramatic effect of a deep-rooted recession.[163]

B. The Downfall of Convertibility Legislation

Convertibility legislation initially produced notable economic improvements, including dramatically reducing inflation from 5,000 percent in 1989 to less than five percent in 1994.[164]

---

156. 2459 L. CIV. (Arg.). Author's translation of statute.

157. *See id.*

158. Keenan, *supra* note 153, at 129.

159. *See* Minikes & Foyt, *supra* note 154, at 450.

160. *See* Steve H. Hanke, *supra* note 147, at 71 (discussing Russia's convertibility plan and the effects of relinquishing monetary policy). The author addresses the importance of having a pervasive full convertibility plan that preserves the value of property. *Id.* Unofficial dollarization in Russia was an attempt to stabilize the capital starved country. *Id.* Under this model, "[f]ull convertibility is the only guarantee that protects people's rights to what belongs to them. Even if governments are not compelled by arguments on the grounds of freedom, the prospect of seeing every asset in the country suddenly lose value as a result of exchange controls should give them pause." *Id.* at 72.

161. Minikes & Foyt, *supra* note 154, at 462.

162. *See id.*

163. *See id.* at 162. *See also* Anthony DePalma, *Fixing Argentina: Whose Job Is It?*, N.Y. TIMES, Jan. 6, 2002, at A4.

164. *See* Pastor & Wise, *supra* note 72, at 62. *See also* Velde & Veracierto, *supra* note 54, at 26. As a result of the currency board legislation, the Argentine government adopted a series of financial reforms, which reduced spending and taxes. Velde & Veracierto,

Additionally, between 1991 and 1994, Argentina experienced an average annual economic growth of almost ten percent.[165] Despite preliminary indicators that this new plan would usher in a new era of economic stability,[166] acute financial stress eventually stifled this prospect.[167] Investment in Argentine markets fell twenty-five percent between 1999 and 2001, and the household poverty rate increased from thirteen percent in October 1993 to twenty-one percent in October 2000.[168] The downfall of convertibility legislation is rooted in a failure to adequately address Argentina's excessive susceptibility to regional financial turmoil, as well as inefficient fiscal, labor and trade policies.[169]

1. Regional and International Trade

The creation of a South American free trade zone known as "MERCOSUR" integrated Argentina's economy with that of Brazil, Paraguay and Uruguay.[170] The existence of MERCOSUR additionally bolstered the trading relationship between Argentina and Brazil.[171] This relationship proved fatal for Argentina, particularly when Brazil's currency devalued by fourty percent during their 1999 financial crisis.[172] As Argentina's premier trading partner, second only to members of the European marketplace,[173] Brazil's financial woes created a severe trade imbalance for Argentina, as thirty percent of their exported goods went to Brazil.[174] When Brazil curbed its spending on foreign goods, Argentina lost thirty percent of its sales.[175] If they had other

---

supra note 54, at 26. These reforms ultimately led to an increased growth rate in Argentina's Gross Domestic Product (GDP), as it increased from a "-1% annual average between 1980 and 1990, to 4.3% between 1991 and 1998. *Id.* Other notable improvements were a newly stabilized consumer price index and stabilized GDP per capita inflation ratio. *Id. See also* Larry Rohter, *Argentina Unlinks Peso From Dollar, Bracing for Devaluation and Even Harder Times*, N.Y. TIMES, Jan. 7, 2002, at A6.

165. Pastor & Wise, *supra* note 72, at 62.

166. *Id.* at 61.

167. *Id.*

168. Pastor & Wise, *supra* note 72, at 67.

169. *See* Argentina: Executive Summary, Quest Economics Database, HILFE COUNTRY REPORT, Oct. 26, 2001, at 1.

170. Pastor & Wise, *supra* note 72, at 62.

171. *Id.*

172. *Id.* at 63.

173. The European marketplace accounts for twenty percent of Argentina's exports. *Id.*

174. *Id. See also Most Likely Regime Scenario, supra* note 123.

175. Pastor & Wise, *supra* note 72, at 62.

sources of demand for their products, this loss of sales would not have impacted Argentina so dramatically.

As a result of Argentina's Convertibility Law, the value of the Argentine peso increased proportionate to the U.S. dollar, making products more expensive and less desirable to overseas buyers, particularly trading partners in Europe.[176] The Argentine Congress amended its convertibility laws to address Argentina's inability to compete with the euro, the predominate currency of Western Europe.[177] Pursuant to this amendment, the value of the peso would change when the dollar and the euro were equal in value.[178] When the dollar and euro achieved parity, the peso would be worth half a dollar and half a euro.[179]

Arguably, the process of integrating its currency with the euro should have allowed Argentine products to flourish in the European markets.[180] Argentina, however, did not invest in developing more sophisticated commodity markets, leaving grain and meat as their top ten export products.[181] This failure to bolster production of more sophisticated, technologically advanced goods, left Argentina with an unproductive, undesirable price-sensitive commodity-based export market, particularly when compared to regional competitors that had invested in production of technologically advanced goods.[182]

2. Labor Reform

The tenets of convertibility legislation disallowed changing the value of the peso, even in the midst of imminent collapse and inability to compete in the global marketplace.[183] Where devaluing the currency was not an option, labor reform became imperative to modify historically inefficient fiscal and labor policies to improve the performance of the economy.[184] Argentina

---

176. *See id.* at 62-64, 69.

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *See id.* Chile and Mexico both developed polices that promoted growth in the production of highly technological goods, in addition to creating other policies that have made their commodities more attractive abroad. *Id.*

183. *See* Posting of Hector Maletta, *The IMF in Argentina: Bailouts for Investors*, INT'L POLITICAL ECONOMY LISTSERVE (Sept. 10, 2001).

184. Pastor & Wise, *supra* note 72, at 65.

passed the 1998 Labor Reform Act to resolve inefficiencies plaguing its labor force, and assented to IMF imposed conditions in support of convertibility reforms.[185]

Notwithstanding a revision of labor policies, changes that stemmed from the Labor Reform Act were not as pervasive as the IMF anticipated.[186] The Labor Reform Act specifically targeted indemnification requirements that forced employers to indemnify ex-employees where the discharge resulted from reduced business activity.[187] These requirements contributed to a high unemployment rate and deterred businesses from hiring new employees in order to avoid paying indemnification costs in the event of an economic downturn.[188] Providing incentives for companies to expand their employment base proved ineffective.[189] Job prospects improved only in the "temp worker" market,[190] while half of the working age population still lacked a regular job, leaving unemployment at a staggering seventeen percent.[191]

The Labor Reform Act, while important, failed to address more fundamental issues. These concerned limitations of commodity markets, which did not create a need for highly skilled workers.[192] An additional factor encumbering employers was the ratio of benefits paid to employees.[193] In Argentina, for every two pesos paid to an employee in wages, employers were required to add an additional peso for employee benefits, while the ratio in most industrialized countries was three to one.[194] What seemed to be a benefit was merely contributing to the detriment of the middle class, as it became harder for companies to stay in business.[195] A frustrated workforce[196] and equally frustrated

185. *See* Keenan, *supra* note 153, at 129-32.
186. *See id.* at 131-32.
187. *See id.*
188. *See id.* at 126.
189. *Wagering on the Dollar, supra* note 70.
190. Pastor & Wise, *supra* note 72, at 181.
191. *Wagering on the Dollar, supra* note 70.
192. *See infra* Part IV.B.1.
193. Pastor & Wise, *supra* note 72, at 64.
194. *Id.*
195. *See* Rohter, *supra* note 164, at A6.
196. Economists believe that the convertibility law was a market force that directly contributed to high unemployment. Keenan, *supra* note 153, at 148. Specifically, artificially increasing the value of the peso caused a corresponding artificial increase in the value of Argentine labor. *Id.* "If an Argentine laborer earned three hundred and fifty pesos per month prior to convertibility, that worker suddenly earned more than seven hundred pesos after passage of the plan." *Id.* The increase in labor costs in dollars caused

employment base exacerbated a deteriorating economy, sealing the ominous fate of the peso-dollar peg.

C. Legislative Balance of Power

The convertibility laws were doomed partly for their relative inflexibility. Implementation required both legislative and executive approval. Although the convertibility paradigm was short-lived, it is important to assess the balance of power between the legislative and executive branches when changing monetary policies.

The likelihood of legislative gridlock and the need for an executive order to facilitate changes illustrate the inflexibility of convertibility laws.[197] A Congressional mandate for a yearly budget process by 2003 made the laws more flexible as it allowed for their modification in the event that budgetary goals were not met.[198] Rigid convertibility legislation made it difficult for the Argentine President to unilaterally make any drastic changes in fiscal policy.[199] Instead, such change would be subject to approval by Argentina's deeply divided bicameral Congress, [200] which had adamantly prevented the president from unilateral decision-making regarding convertibility laws.[201] Legal analysts asserted that the Argentine executive branch could issue an executive order to override Congress.[202] Such an order would have profound implications.[203] In essence, the limited power of the President under convertibility legislation could only be challenged if the President petitioned the Supreme Court to override the very

---

Argentine businesses to reduce costs by lowering salaries and hiring fewer people. *Id.* at 148-149.

197. *See* Maletta, *supra* note 183.

198. Sebastian Edwards, *The Americas: The IMF is Panama's Lender of First Resort*, WALL ST. J., Sept. 24, 1999, at A15.

199. *See* Maletta, *supra* note 183. De La Rua's party, the UCR, is an alliance grouping which is the largest political bloc in the Congress, but it falls short of an overall majority. *Argentina: Second and Third Most Likely Regime Scenario.* THE PRS GROUP/ POLITICAL RISK SERVICES, July 1, 2001. The Peronists (opposing party) control the Argentine Senate and their governors represent two-thirds of Argentina's provinces. *Id.* This is problematic, particularly because governors wield great influence over Congressional policies and spending. *Id.*

200. *See* Maletta, *supra* note 183.

201. *Id.*

202. Article 76 of Argentina's Constitution grants the President power to issue decrees exempt from Congressional challenge. *See* The Argentine Tango: Politics and Economics at an Inflection Point, OFFITBANK, MARKET COMMENTARIES, Mar. 2001.

203. *See* Maletta, *supra* note 183.

pronouncements of convertibility legislation that limited his power.[204] In short, the President could only broaden his power if the Argentine Supreme Court[205] declared convertibility laws unconstitutional.[206]

D. Is the Prospect of Dollarization Feasible in Light of Argentina's New Economic Plan?

Ecuador's relationship with the dollar stems from a model created by former Argentine Finance Minister Domingo Cavallo.[207] In 1996, Ecuadorian president Abdala Bucaram, within weeks of his election, summoned Cavallo to devise an economic plan for Ecuador that would tie the Ecuadorian currency to the dollar.[208] Cavallo's advisors[209] urged that any legislation implementing dollarization should be premised on many factors.[210] These include stifling the Central Bank's ability to print currency, converting all wages, prices, assets and liabilities from pesos to U.S. dollars, and repealing any previously enacted legislation which interferes with the goals of full dollarization.[211]

On January 6, 2002, with unprecedented haste, the lower house of Argentina's Congress approved newly-elected President Duhalde's devaluation plan, repudiating ten years of convertibility legislation.[212] Although the convertibility plan forced the Argentine government to pursue aggressive fiscal policies, such as reducing inflation from 5,000 percent a year to under ten

---

204. *Id.*

205. *See* Dr. Ernesto N. Kozameh, et al., GUIDE TO THE ARGENTINE EXECUTIVE, LEGISLATIVE AND JUDICIAL SYSTEM, *at:* http://www.llrx.com/features/argentina.htm (describing the role of the Argentine Supreme Court as the final arbiter of Federal Justice, particularly with regard to interpretation of the National Constitution).

206. *See* Maletta, *supra* note 183.

207. Rohter, *supra* note 164, at A6. *See also* Mark Falcoff, The Ecuadorian Disease, AEI LATIN AMERICAN OUTLOOK, Oct. 2000.

208. The first steps of the Cavallo plan led to a fivefold increase in the price of electricity, a threefold increase in the price of domestic gas and a sixty-five percent increase in the cost of public transportation - clearly the Cavallo plan was not a viable solution for Ecuador. *Id.*

209. The Argentine Tango: Politics and Economics at an Inflection Point, *supra* note 202 (emphasizing the power bestowed upon Cavallo to maintain the integrity of the Argentine economy).

210. Steve H. Hanke, *Dollarize Argentina, Now,* NAT. POST (Can.), July 14, 2001, at C11.

211. *Id.*

212. Rohter, *supra* note 164, at A6.

percent,[213] critics argued that convertibility only encumbered the economy.[214] It created a four-year recession, leaving the country bankrupt and on the verge of a political meltdown.[215]

Argentina's economic future is once again in a state of unrest with a clear solution nowhere in sight. Whether the current devaluation scheme is a step in the right direction, or "[w]hether Argentina is going to pay an enormous cost to exit one scheme that ceased working only to return to another that in the past led to catastrophic hyperinflation" is virtually impossible to ascertain.[216]

While the future of Argentina's relationship with the dollar is uncertain, continued internationalization of their markets and banking practices remain critical factors for growth and legitimacy in international markets.[217] Economists argue that "[i]t is an absolutely fundamental error for someone to conclude that Argentina is a mess because it embraced market economics."[218] The possibility of protectionist regimes, however, being used as mechanisms for internal stability is likely, particularly if convertibility legislation and market economics are blamed for the status quo.[219]

1. Legislative Flexibility

Although financial gains realized under convertibility legislation were short-lived, it is still possible to visualize use of the dollar in Argentina. The failures of convertibility do not stem from use of the dollar, but rather the inability to modify economic laws once it became clear that they were not helping the economy.

The differences between convertibility legislation in Argentina and Trolley Bus Legislation in Ecuador demonstrate that dollarization, if properly implemented, could be successful in Argentina.[220] For example, Trolley Bus Legislation successfully provided for labor reform and flexibility in Ecuador, while labor reform under convertibility legislation in Argentina only frustrated

---

213. *Id.*
214. DePalma, *supra* note 163.
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.*
220. *See infra* Parts III.A, IV.B.

the working class and exacerbated tensions between employers and employees.[221] As a matter of legal policy, for Argentina to realize similar across-the-board gains as manifested in Ecuador, the first step is to address divisions in congress that promote gridlock and preclude changing existing laws where their failure is imminent.

It is imperative that laws designed to implement a new economic plan remain flexible, particularly when the future of the economic plan is uncertain. Full dollarization is a pervasive and irreversible measure;[222] however, the equally pervasive nature of convertibility laws did not realize their full potential in implementing the drastic changes needed to resuscitate Argentina's economy.[223] Modifying convertibility laws in Argentina, prior to their repudiation, required an executive order.[224] Conversely, in the Ecuadorian dollarization model, the branches of government worked together to redraft more than 30 thirty laws providing for dollarization and rapid economic modernization.[225] The foregoing demonstrate that Ecuador's commitment to flexibility translated into financial success while Argentina's inflexibility contributed to its demise.

2. Banking Reform and International Agencies

One step toward achieving financial gains obtained from convertibility legislation would be to adopt a series of banking reforms similar to those initiated in Ecuador's dollarization model.[226] These banking reforms would provide an institutional framework for fiscal responsibility, and would bolster Argentina's fiscal credibility among its trading partners.[227] Creating agencies to maintain fiscal discipline is also critical.[228]

> [W]hile dollarization provides for price stability, it cannot guarantee fiscal accountability. As long as the IMF exists, the temptation to use its generous funding programs as a surrogate for a central bank will likely be too great for most politicians to resist. Supporters of dollarization for Argentina should take

---

221. *See infra* Parts III.A, IV.B.
222. *See infra* Part II.A.3.
223. *See infra* Part IV.C.
224. *See* Maletta, *supra* note 183.
225. *Ecuador: Back from the Brink*, *supra* note 110.
226. *See* Edwards, *supra* note 198, at A15.
227. *Id.*
228. *Id.*

heed; adopting the U.S. dollar, without placing fiscal restraints on politicians may lead to a permanent revolving IMF mission in Buenos Aires.[229]

Critics of the IMF and the United States (the IMF's largest shareholder) point to these entities' unwillingness to help Argentina in their time of need as a factor that is exacerbating the problem.[230] What is perceived as an unwillingness to help stems from a history of economic mismanagement by Argentina.[231] Furthermore, the United States and IMF fear that excessive loans only diminish the accountability of investors and policymakers who anticipate a lending agency bailout.[232] A better approach, however, simulates the Ecuadorian model. Ecuador balanced radically changing internal fiscal policies with obtaining outside assistance.[233] The end result was a healthy economy that would eventually sustain itself.[234] Loans cannot substitute for sound fiscal planning. IMF support must encourage Argentina's new government to promote the free market paradigm, and to invoke sound fiscal and banking controls.[235]

The Ecuadorian model of enacting banking reform laws is noteworthy in the case of Argentina. Ecuador's commitment to standardizing their banking policies not only garnered the respect of the international community by fostering investment, but also helped in creating economic stability.[236] The current lack of stability in Argentina's banks, however, is perpetuating mistrust among its citizens and the international community.[237] Specifically, former Finance Minister Cavallo planned to use part of an $8 billion loan from the IMF to change the role of the central bank.[238] While preliminary indicators showed a substantial increase in the number of bank deposits, it was offset by the withdrawal of $10.58 billion dollars after citizens feared the banks

229. *Id.*

230. Joseph Kahn & David E. Sanger, *Bush's Policy on Argentina Signals Shift in Approach*, N.Y. TIMES, Jan. 5, 2002, at A3.

231. *Id.*

232. *Id.*

233. *See infra* Part III.A-C.

234. *Id.*

235. *Id.*

236. *See infra* Part III.A.

237. *See* Barham, *supra* note 2.

238. *Id.*

would collapse.[239] Enactment of a dollarization plan, addressing the role of the central bank, and bank reform in general, would all contribute to financial stability in Argentina.

V. CONCLUSION

Ecuador's gradual economic stabilization lends credence to the proposition of dollarization in Argentina.[240] Currency stability, enhanced foreign and domestic investment, and an increase in its gross domestic product are factors that foster the Ecuadorian people's confidence in their economy.[241]

Economists theorize that dollarization would benefit Argentina by eliminating the peso-dollar exchange rate risk, lowering interest rates, and stimulating growth.[242] The severity of Argentina's forty months of recession and devaluation also indicate the need to adopt a full dollarization plan.[243] Left alone, Argentina's historically unstable currency will continually devalue, which would be disastrous as it would only deflect investment and stifle confidence in the economy.[244]

Argentina must be willing to implement additional radical fiscal, labor and export reform policies with the help of international agencies, while creating a foundation that will avoid a pattern of dependence on such funding.[245] These policies, in addition to previously discussed economic measures such as overhauling banking practices, include investing in technologically advanced commodity markets and broadening labor reform legislation to enhance the availability of highly skilled workers.[246] These measures, coupled with internationalized banking and investment policies, whose implementation enhances foreign investment, will engender an era of economic stability in Argentina. It was not until Ecuador internationalized its banking practices, which included changing spending, borrowing and

---

239. *Id.*

240. Jim Wyss, *Greenback Guinea Pigs*, LATIN TRADE, Aug. 2001.

241. *Id.*

242. Steve H. Hanke & Kurt Schuler, *A Dollarization Blueprint for Argentina,* Feb. 1, 1999 (LEXIS), this study originally appeared in *Friedberg's Commodity and Currency Experts' Report."*

243. Stephen Wisnefski, *Dollarization Talk Gets More Serious Attention,* DOW JONES ARGENTINA, (Brady Net, Oct. 19, 2001).

244. *See infra* Part IV.

245. *See id.*

246. *See infra* Part IV.B.

planning polices, that it reaped the benefits of a dollarized economy.[247]

Argentina's protectionism and rejection of international banking practices jeopardizes the future of free trade agreements, with ramifications that would not be limited to the region.[248] As a result, Argentina's future should be considered by the international community, conditioned upon drastic changes in internal policies.[249] Convertibility was a first attempt to formalize a relationship with the dollar. It failed because policies required to sustain long-term financial growth were not considered. Without such policies in place, any economic plan is destined to fail.

*Caroline R. Hurtado**

247. *See infra* Part III.A-C.
248. *Id.*
249. *Id.*

* J.D. Candidate, Loyola Law School, Los Angeles, 2003; B.A., International Relations, University of Southern California. I dedicate this Comment to my grandparents, Luis and Carolina Reynoso, who have been the greatest source of inspiration in my life. This article, from subject matter to work involved in preparing it, is a culmination of your influence and values, which I will always treasure. To my mom, Josie, I attribute who I am today to your high standards, love and unfaltering belief in me-may I one day be half the woman you are!! To my brother, Erik, thank you for always making me laugh and for encouraging me, especially while I wrote this article, I cherish you. Janelle, Curran, Angie, Gail, Petty and Alma, you have formed a precious circle around me and I thank you for your unconditional support and the balance you add to my life. To the staff and editors of ILR, including, Damon Huss, Jennifer Sawday, Joseph Ceglio, Marian Selvaggio and Peggy Fu, I am grateful for your candor and work on this article. For each of these people, and for everything I have, I thank God, but for whose grace I would have nothing.