Picking Up the Pieces:
Comparing the Social Impacts of Financial Crisis in Mexico and Argentina

By:

Manuel Pastor
Latin American & Latino Studies
UC Santa Cruz

&
Carol Wise
School of International Relations
University of Southern California

Draft (9/03)

All tables and figures at the end.

Draft only: Please do not cite or quote without permission.

Introduction

After a committed process of macroeconomic stabilization that began during the mid-1980s in most of Latin America, many observers began to speak of the need for a next generation of reforms that could more firmly establish the bases for economic growth and correct for longstanding distributional inequities. By the mid-1990s serious reformers like Argentina and Mexico seemed to be on the cusp of tackling this distributional backlog by launching so-called second phase market reforms meant to correct for earlier shortcomings in the social realm (Naím 1995; Pastor and Wise 1999). However, in both cases financial crises erupted: Mexico's crash of December 1994, which saw a forty percent devaluation of the peso and a massive outflow of portfolio capital; and, more recently, Argentina's meltdown which had simmered since the Brazilian devaluation of 1999, but exploded in 2001-2 and prompted policy makers to abandon their commitment to a fixed exchange rate under a currency board that had been anointed as the "Convertibility Plan" back in 1991.

In this paper we re-examine these financial crises from the standpoint of social tensions and distributional concerns. While the data confirm that unemployment and wages took a major hit in the aftermath of these respective crises, we argue here that misguided attempts in both countries to ameliorate social stress *prior* to the crisis contributed to both the timing and the magnitude of the shocks when they did hit. In other words, while there were many important financial factors and miscalculations that led to crisis, each country's bout of severe financial stress was at least partially induced by efforts to paper over distributional tensions through some combination of exchange rate appreciation and "safety-net" spending that failed to directly tackle the growing social backlog. In the end, ironically, neither the macroeconomic strategies that were employed to avoid distributional pain (e.g. low exchange rates that favored domestic consumption) nor the use of slipshod safety-net programs (e.g. Mexico's National Solidarity Program or Argentina's reliance on loose provincial spending and a thin patchwork of national social programs) constituted the social cushion that policy makers hoped would insulate them from the electorate's wrath.

The policy course that was followed after Mexico's crisis may, however, prove instructive. For Mexico, the 1994-95 financial crisis was a catalyst in two respects. First, it prompted the shift to a flexible exchange rate regime, a sweeping reform of the banking system

and numerous other institutional innovations (Boylan 2001; Wise 2003a: 44-50). Second, policy makers were compelled to revamp a broad but thin safety-net strategy and in its place eventually launched a highly acclaimed program (PROGRESA) based on aggressive targeting and increased investment in human capital. Although not without its own flaws (including delayed implementation and insufficient coverage to date), Mexico's more targeted approach, in combination with a shift to a more flexible and institutionalized macroeconomic strategy, has produced some concrete results in the areas of poverty reduction and distributional improvement.

In Argentina, the distributional future seems less promising. The "tequila effect," or spillover of the Mexican crisis to the Argentine economy in 1995, provided a useful warning signal; nevertheless, having finessed their way out of the crisis through financial reform and the shrewd management of reserve requirements, Argentine policy makers became intent on maintaining the fixed exchange rate at all costs. As unemployment continued to rise precipitously from this point on, the government could have followed the Mexican path and adopted new innovations in social policy, particularly given the leeway provided by a restoration of growth after the lean year of 1995. Instead, the Argentine authorities generally relied on currency appreciation and fiscal slippage to the less developed provinces as a way of keeping the social peace. These trends contributed to the eruption of an even more severe financial crisis in January 2002, marked by a default on the country's publicly held debt, the final collapse of the decade-long fixed exchange rate, and the implementation of 1970s-style capital controls.

The country has since fallen into a policy abyss, as efforts to craft a broad coalition that can foster the consensus and fortitude necessary to launch another round of reforms have yet to take hold. Despite the expansion of one innovative employment program for heads of households (with the support of the multilaterals), Argentina's current social strategy mirrors its political morass: social policy generally remains fragmented, overlapping and largely ineffectual. Downward mobility is rampant, and the federal government has yet to wean itself from the granting of ad hoc fiscal concessions in the name of universal coverage at the provincial level.

In this paper we explore the double-edged role that social stress has played as both a contributing cause and a consequence of financial crisis in Mexico and Argentina. In part one of the paper, we briefly examine the literature on the expected effects of financial crashes on key social indicators; we then turn the analysis around to offer a political economy account of how a failure to tackle distributional issues seriously can itself lead to financial crisis. We do not wish

to overstate the contributing role of these distributional pressures, although we do believe them to be important in explaining the political stalemates that led to “wars of attrition” (Alesina and Drazen 1991) and hence policy “mistakes.” Part two discusses the specific experiences of Mexico and Argentina, setting an empirical baseline in terms of pre- and post-crisis patterns of income distribution and employment, as well as the kinds of social policy initiatives and public spending patterns that have accompanied programs of emergency stabilization in the two countries.

Part three concludes by discussing a puzzle: Why did Mexico move to a more efficient and targeted social policy in the wake of its financial crisis while Argentina did not take advantage of the opportunity to do the same in response to the 1995 tequila shock? Although a rich literature has emerged on the politics of economic reform in Latin America over the past decade, standing explanations based on leadership, political parties and interest coalitions do not offer a full answer to these questions (Wise 2003b). Indeed, as some of the recent research on reform politics would have it (Haggard and Kaufman 1995; Corrales 2002), Argentina, with a democratically elected executive, competitive political parties, and broad-based interest coalitions, would seem to be the more likely of the two cases to successfully navigate a financial crisis and reverse the tide of regressive income trends (Niles 2001: 10). By contrast, Mexico, under the tight control of the semi-authoritarian PRI (Institutional Revolutionary Party) party from 1929-2000, with weak opposition parties and narrowly-based interest coalitions, would have been considered much less likely to do so (Craig and Cornelius 1995; Whitehead 1998). Yet, it was Mexico that rose to the occasion in resolving its financial crisis and shifting its social priorities in a more equitable (albeit only slightly more so) direction.

We argue that the deeper causes of this difference can be found in the political economy structures that have governed policy-making in the two countries as well as more conjunctural factors, such as the creative leadership of certain policy makers who both made the connection between equity enhancement and growth and found the bureaucratic foxholes from which to operate. We acknowledge that this is a preliminary attempt at addressing this question – but we also stress that the matter is more than one of academic concern. In light of the severe crisis that befell Argentina, where half of the population has slipped below the poverty line, it seems that an exploration of new policy frameworks is in order. Hence, we close by drawing some lessons

from Mexico's recent experience for Argentina's future, both in terms of required political reforms and the space and need for a more carefully targeted social policy.

Part I. Financial Crises and Distributional Consequences

Financial crises in the developing world often have dramatic effects on the real economy, including on output, employment, and wages. While there is a general sense that such crises may have regressive distributional consequences, including deterioration in the real standard of living for the poor, both the causal chains and the specific effects are still debated in the economic literature.[1]

Baldacci, de Mello, and Inchauste (2002) provide a useful overview of the effects of such currency crises on distribution and poverty, including a preliminary econometric analysis of both effects and the chains of causation that bring them about. The authors suggest that financial crises can impact distribution and poverty in several different ways, including the harsh effects of an associated recession on labor demand, detrimental shifts in relative prices due to rapid monetary changes, cuts in social spending as part of a general fiscal contraction, and rapid changes in asset values as the crisis works its way through the financial system.[2]

However, it is important to note that not all of these impacts are necessarily regressive. In particular, to the extent that currency devaluation shifts relative prices toward exporters and agriculture, there is a medium-term possibility of improvements in income for the poor. Further, to the extent that the poor are already weakly integrated into the financial system, a loss of deposits and/or higher interest rates may have little effect on those at the bottom of the social pyramid. Of course, this does not mean that only the wealthy are affected, as they may be in the

---

[1] Although there is a rich literature on the effects of macroeconomic crises on distribution (see, for example, Lustig 1995), less has been written on the specific effects of the sort of financial/currency crises characteristic of the two cases reviewed here. Note that we spend little time here on the various asset or wealth transfers that take place, some of which may redistribute winners and losers without noticeably affecting the gap between rich and poor; such transfers are important, as they insidiously shape the outcome of political economy games, but their measurement would require a new paper altogether. Thus, in this paper our focus is more on the poor, generalized income distribution, and social policy.

[2] Baldaccci et al (2002) also stress the need to focus on distribution *per se*. While many economists emphasize the poverty headcount, believing that distribution is mainly a matter of normative concern, these authors note that poverty estimates based on sampling between census counts may be erroneously based on the assumption of a constant distribution of income. However, if a distributional shift is occurring for other reasons, such as a financial crisis, it will affect poverty. This is amply demonstrated in the Argentine case.

best position to protect assets via capital flight. Indeed, the Mexican and Argentine cases suggest that it was the middle class sectors that suffered the most significant asset losses; these asset transfers can, however, be complex and depend on the extent to which savings and/or deposits were in local currency.

Still, we would expect that, at least in the short-run, the recessionary and fiscal effects of financial crisis might disproportionately impact the poor. Using a relatively small sample of 65 observations of currency crises, Baldacci et al (2002) do find deterioration in poverty indicators, with distributional losses more severe for those who are not in the absolute lowest deciles of the income pyramid.[3] There is also some evidence of slight declines in government spending on health care and education. In one detailed study of Argentina, Ravallion (2002a) found the elasticities for social spending cuts to be especially high in the context of financial crises that lead to downward shifts in aggregate government spending; moreover, social spending also seems to become less well-targeted toward the poor as it contracts (with some particularly strong evidence for this in the case of Argentina; see Ravillion 2002b). Thus, even though much social spending in Latin America remains poorly targeted, these crisis-inflicted social spending cuts are indeed associated with deterioration in the distribution of income.

One strand of the literature also points to the possibility of distribution itself having an impact on currency crises. While once considered simply an output of the economic process, a number of social scientists are now arguing that the prospective distribution of gains and losses can, through various political economy mechanisms, impact growth, inflation, exchange rate policy, and other measures. Specifically, some have argued that high levels of inequality can, among other things, reduce society's sense of broad gain from investment and encourage median voters to seek distributional redress at the polls. This, in turn, can distort economic incentives and undermine the security of property rights.[4] It has also been suggested that inequality may be associated with political instability (Birdsall and Londoño 1997; Birdsall 1999), although some studies argue that it is changes in distribution, and not just a steady state of inequality, that may be more important in this regard (Nafziger and Auvinen 2000).

---

[3] The number of observations (or "n's") fall further depending on the variable in question: the n's for the GDP, inflation, and fiscal variables range from 41 to 59, while the n's for the poverty, unemployment, and distributional variables range from 21 to 38.

[4] For a recent summary of the various arguments and the literature, see Thorbecke and Charumilind (2002).

The latter insight regarding political instability and the failure to make coherent policy choices has been employed in a "war of attrition" model developed by Alesina and Drazen (1991) to explain delays in stabilization packages.[5] Essentially, heterogeneous interest groups all recognize that a fiscal adjustment is necessary but decide to wait each other out until one group finally concedes and agrees to pay a disproportionate share of the adjustment burden; in the interim, the monetary authority, lacking structural independence, covers the deficits with emissions and accelerating inflation is the result. Such behavior would, of course, not occur if heterogeneous actors fully knew the preferences and willingness of all other agents to bear the adjustment burden (and hence were able to get to the end-game quickly and reduce the waiting costs). Thus, "holding one's cards" only works if some cards are being held quite close to the vest.

As we see it, while the "war of attrition" model was initially developed to explain inflation as a signal of delayed stabilization, its application to these recent currency crises in Mexico and Argentina could offer some useful explanatory insights. This is especially so for the Argentine financial crisis of January 2002, where explanations based on fiscal versus exchange rate policy continue to compete for attention. While both were clearly critical in provoking the crisis, the value-added by the war of attrition model is that it offers a political economy framework that is essential for mapping the interplay between the independent variables. For example, when Argentine fiscal policy is analyzed through this lens, the chronic delays in adjusting the fiscal accounts can be attributed to the conflict between the provincial and federal authorities (rather than technical factors alone),[6] as well as to a broader struggle over whether urban elites or the provincial popular sectors would bear the brunt of the adjustment burden. The federal government's decision to allow the provinces to issue their own script prior to the 2002 crash – basically a stall tactic, as the federal-provincial power struggle continued under the

[5] Faucher and Armijo also employ the Alesina-Drazen (1991) analysis in their accounting of delays in devaluation, albeit with a slightly different focus than the distributional angle that we emphasize here.

[6] The tug of war between decentralization and recentralization of fiscal policy in Argentina has been nested in a broader political dance since the first Menem administration (1989-1995), given that the fixing of the exchange rate under a currency board created ever more stringent demands for a sound fiscal policy. However, old-style political arrangements, and the mutual need for federal and provincial politicians to scratch each other's backs, has resulted in fiscal spending patterns that eventually undermined the fixed exchange rate. Regarding this political co-dependence, Garman, Haggard, and Willis (2001: 231) note, for example, that "governors and regional party leaders exert influence over the composition of candidate lists for the federal legislature, but national party leaders in both the Peronist and the Radical Parties exert some degree of veto power over the makeup of the lists generated by provincial party commissions." In this set of confused arrangements, fiscal discipline can easily break down.

pretense of salvaging a fixed exchange rate – worked to both prolong the agony and magnify the costs for both sectors, an outcome reminiscent of the suboptimal end-states in the Alesina-Drazen model.

The choice of a particular exchange rate strategy can also reflect a political stalemate of this very sort (Frieden 1994; Faucher and Armijo 2003). Elsewhere, we have argued that in both Mexico and Argentina, one way out of an earlier inflation-driven war of attrition was to adopt a fixed or semi-fixed exchange rate regime (Pastor and Wise 1994; Pastor and Wise 1999). In Mexico, for example, the decision of the outgoing de la Madrid administration (1982-1988) to adopt a "crawling peg" in 1987—the peso was tied to the dollar and fluctuated by a tiny amount on a daily basis— had the expected downward impact on inflation. This, along with some creative vote-counting in 1988, allowed the government party (the PRI) to hang on to power as it faced its first authentic oppositional challenge in six decades. However, the persistence of a semi-fixed and appreciating exchange rate up until 1994 was another matter: this helped to mask deteriorating distributional conditions as the PRI scrambled to reassemble a political coalition that could survive another national election in 1994. Crudely put, in the era of market reforms, Mexico's pegged and overvalued exchange rate helped support domestic purchasing power---a function that a once-benevolent state had found it increasingly difficult to play.

In Argentina, when monthly rates of inflation shot from 90 to 200 percent in 1989-90, the newly elected Menem administration had little choice but to pursue one of the most credibility-enhancing strategies available to a country in the throes of hyperinflation: a currency board, which fixed the Argentine peso one-to-one to the U.S. dollar, and established full convertibility between the two currencies (Williamson 1995; Wise 2000). For nearly a decade, peso-dollar parity seemed to have put an end to the sectoral cleavages and zero-sum politics that had finally exploded into hyperinflation back in 1989 (Díaz-Bonilla and Schamis 2001). A fixed and appreciating exchange rate no doubt also helped Menem to persuade the large labor-backing within his Peronist party to accept a sweeping program of trade liberalization and privatization, especially since candidate Menem had made no mention of these reforms prior to his election. Commercial opening would, after all, allow newly dollar-rich Argentines (at least those who could retain employment) to exercise their consumption power, while privatization provided the hard currency inflows necessary to shore up the fiscal accounts, cover a growing trade gap, and prop up the convertibility scheme.

In short, fixed currencies in Mexico and Argentina temporarily helped to quell the usual domestic battles over relative prices by explicitly using the exchange rate to help keep the social peace. Again, however, the trade-off for price stabilization and enhanced credibility in both countries was the gradual appreciation of the currency. This imposed costs on those in the tradable sector, who tend to prefer a more competitive or downwardly flexible rate favorable to exports (Frieden and Stein 2001), but the restoration of growth and the offering of other tax and financial incentives greatly eased their pain.

It may seem odd that this strategy was validated by a supposedly rational market, given that Latin America's economic landscape, and Argentina's in particular, has been littered for several decades with failed experiments involving similar exchange rate-based stabilization policies (Cardoso 2000; Corden 2000; Frieden, Ghezzi and Stein 2001). But the post-1982 "Washington Consensus," while heavily endorsing market reforms, hedged on the question of which exchange rate strategy would be most likely to bolster stabilization and help to sustain a longer-run market strategy. In the interim, the resurgence of capital inflows, many of them securitized, and the renewed ability to borrow in the 1990s distracted policy makers and their constituents in both Mexico and Argentina from one unavoidable fact: the income streams necessary to viably maintain a fixed exchange rate regime were simply unsustainable.

Recent work by Galiani, Heymann, and Tommasi (2002) suggests how in the Argentine case this unlikely and ahistorical notion that the future stream of income would be permanently high and positive helped to provoke the crisis. Essentially, such expectations were codified into binding contracts between predominantly private actors, particularly with regard to borrowing. Supposedly "locked in" by contracts based on increasingly unrealistic expectations and lured by a false sense of security (property rights weren't actually so binding as was thought and private initiative was still too attuned to public favors), agents simply stuck to their guns despite a political economic scenario that turned increasingly surreal.

One is reminded of the scene in Mel Brooks' Western comedy, *Blazing Saddles*, in which a newly arrived lawman, threatened by a hostile crowd, puts a gun to his own head and threatens to shoot the sheriff; the claim is so absurd that the townspeople believe it and let him go. The fixed exchange rate commitments in both countries were not unlike this fictional satire– they were so "incredible" that they achieved credibility, even as the economic fundamentals were unraveling. Particularly in Argentina, where the drama played out much longer, Finance

Minister Domingo Cavallo boldly followed the script, threatening to shoot himself with an unsustainable exchange rate commitment and zero-deficit fiscal schemes, though in the end few believed him.[7]

In the movie, of course, the sheriff not only survives but thrives. Mexico and Argentina were a bit less fortunate. In the macroeconomic game of truth or dare, the various agents stuck to their contracts and essentially walked off the plank together. Both countries took a plunge, with the Mexican crisis of 1994 constituting a momentary lapse into instability and Argentina's forced devaluation of 2002 a seemingly interminable free-fall.

Could these crises have been avoided by a social strategy not dependent on currency overvaluation to pump up the electorate's sense of confidence and purchasing power? Probably not. Over the course of these exchange rate-based stabilization programs, too many actors, both foreign and domestic, had developed vested interests in delaying devaluation until it became absolutely unavoidable. A more targeted and sophisticated social strategy would surely have taken the sting out of a downwardly flexible exchange rate, as we've seen in post-devaluation Mexico, and thus made a passage from currency fixes more politically palatable. But the reliance on currency appreciation to prop up purchasing power in both countries prior to an exchange rate adjustment was also part and parcel of the market reform process. What better way to grease the social wheels, as policies of liberalization and privatization reduced the capacity of policy makers in each country to viably address distributional pressures? Couple this with the flawed fiscal strategies in both countries---resistance to a comprehensive program of tax reform and the inability to impose compliance costs on some agents---and the recipe for crisis seems complete.

Surely a more targeted and efficient strategy toward the poor would have helped to spare the tremendous waste in human resources that spanned the pre-and post-devaluation periods, and this could have facilitated a quicker post-crisis recovery at the level of the real economy. Alesina and Drazen (1991: 1171) suggest that if "it is the poor who suffer most in the pre-stabilization period, they bear the largest share of the costs of stablization." Thus, we would expect that in cases such as Mexico and Argentina where the run-up to collapse was indeed accompanied by a markedly regressive distribution of income, these regressive trends might have worsened in the immediate aftermath. Interestingly, this squares with the Argentine experience,

---

[7] As suggested in the text, the "zero-deficit" strategy of Domingo Cavallo in 2001 is an excellent example of a policy that was designed to be so incredible that it would be credible. But in the end, few market actors were fooled and country risk skyrocketed. See Pastor and Wise (2001).

but not necessarily with that of Mexico, and this raises key questions of political economy and policy choice.

In the case of Mexico, it does appear that the transformation of the country's trade and production structures under the thrust of North American integration is finally forcing more progressive changes at the level of wages and distribution, and greater macroeconomic flexibility since 1995 is a large part of this story (Pastor and Wise 2003a). Mexican growth is driven largely by investment in export-led sectors with increasing sophistication and higher value-added; total trade as a percent of GDP now approaches 30 percent. In contrast, despite its active participation in the Southern Cone Common Market (Mercosur) through the 1990s, Argentina's trade and production structures changed very little over the course of the Convertibility Plan (1991-2002). Exports are still largely natural-resource based, low value-added and, at 8 percent of GDP, total trade stands just about where it did back in the 1970s (Pastor and Wise 1999). The sources of growth for Argentina have been services and non-tradables, sectors not known for job creation or income gains---almost a reverse image of Mexico.

The difference in development models provides at least a partial explanation for the shift in momentum on the distributional front between the two countries. In other words, the fact that Mexico has pursued an aggressive export-led strategy since the late 1980s while Argentina has stuck with a kind of defensive laissez-faire now seems to be taking its distributional toll on the latter. But what explains the differences in policy choice? How is it that Mexican policy makers were able to re-group from the 1994-95 crisis and launch a targeted social policy that now, five years into the effort, is making a measurable difference (IFPRI 2000; World Bank 2003)?

In the political economy literature, it has long been axiomatic that behind every policy exists a coalition or some band of special interests that must be driving it.[8] This was certainly the case with the launching of the safety-net National Solidarity Program (PRONASOL) under President Carlos Salinas (1988-94), as this was the PRI's answer to pork and patronage under extremely tight budget constraints. Argentina's social strategy has been underpinned by similar coalitional dynamics, whereby its myriad of social programs in the 1990s were used to smooth over tensions between political parties, between sectors and income groups, and between the federal and provincial governments.

[8] See Gourevitch (1986) for a classic treatment of this phenomenon.

But in post-devaluation Mexico, policy success in the realm of social strategy has been, if anything, an iconoclastic exercise. Amidst the distributional wreckage that immediately hit in 1995, a handful of front-line technocrats operating out of the Ministry of Finance (Hacienda) took a hard look at the government's overall spending on social categories (health, education, housing). What they saw was some 135 social programs spread across the various ministries, with the bulk of social expenditure going toward food subsidies. The disbursement of funds was vertically embedded in the PRI's own governance structures, biased toward urban constituencies, and highly inefficient. This small esprit d'corps was able to seize the initiative in the post-crisis atmosphere, and exercise their control over the budgetary process to launch a more targeted and horizontally run strategy called PROGRESA from an institutional base outside of the Ministry of Social Development.[9] At the same time, social policy was removed from the domain of the PRI, and instead run according to more neutral criteria based on eligibility, the compliance of program participants and a balance between the rural and urban sectors. Perhaps most important, by targeting spending on health and education to those most in need PROGRESA and its successor program ("Oportunidades") offer the kinds of social policy instruments that are essential for enabling the structural poor to better survive shocks like those that hit in 1994.

Again, the Argentine social strategy is virtually the opposite of Mexico's: still heavily entrenched in party politics, including the battle for federal versus provincial control over outlays, and bogged down in a bureaucratic mosaic that encompasses some sixty programs and largely favors the provinces (World Bank 2000). Although economic liberalization placed similar demands on Argentina for fiscal austerity and a more targeted and efficient social strategy, the country's internecine political system continues to impede progress on this front; by contrast, in Mexico, out of a similarly complicated process of economic and political liberalization, a small group of committed policy makers was somehow able to rise above the fray of domestic politics and design the kinds of social policy instruments that can help to both deter exchange rate blow-ups and cushion the poor from future macroeconomic shocks.

One could also argue that Mexico's progress is due to better luck over the past decade, i.e. higher growth rates, more generous multilateral support and privileged access to the U.S. market afforded policy makers the breathing space necessary to experiment with innovative

---

[9] Two of the key players in the Ministry of Finance were Santiago Levy, under-secretary of the budget at the time, and Evelyne Rodriguez, director of the budget for social spending. Authors' interview with Evelyne Rodriguez on July 9, 2003, Mexico City.

policies. While its participation in the North American Free Trade Agreement (NAFTA) may have given Mexico a leg-up of sorts, the data show that average Argentine growth rates in the 1990s easily outpaced Mexico's, and until Argentina's debt servicing difficulties erupted in 2001, there is little evidence that multilateral support was anything but forthcoming. Yet, Mexican social policy has now moved in to a second stage, where policy makers are actively debating the finer points of income incidence (World Bank 2003), while Argentina continues its struggle to define the appropriate emergency measures. At the very point when the proper mix of such policies is of the essence, such debates are still mired in domestic politics.

The paradox for domestic politics in Argentina is that the depth of the impact on distribution, generally, and on the poor in particular, can be mitigated by the implementation of the appropriate emergency programs. There may be some dispute about whether such programs should be relatively straight-forward income transfers, or if they should also involve work or other components. But there is little disagreement as to the efficacy of targeted social intervention. As for the finer points, some suggest that a targeted investment-based approach is the quickest way to lower poverty and at the same time cultivate political support (Ravallion 1991; Subbarao 2003); in other words, the targeted investment-based approach can generate a better social bang for the compensatory buck. Others, such as Mahoney (2001), caution not to hold back part of the emergency resources allocated for longer-term investment (such as the complementary investment components needed for community make-work programs or contingency requirements that the money be spent on education or other social goods) as this can generate inefficiencies. [10]

In retrospect, a main lesson from the 1980's was that policy remedies meant to cope with macroeconomic shocks sorely lacked a distributional component. Thus, in Mexico, the 1994 crisis afforded policy makers another opportunity to correct for past errors in this realm. After launching a short-term compensatory program in the wake of the 1994 crisis, Mexico's social strategy then evolved into an approach that borrows from the best of the social policy research just cited. While Argentine politics appear to have stabilized since the April 2003 election of President Nestor Kirchner on the Peronist Party ticket, the recent crisis has not translated into a

[10] There is an additional view that targeting the poor might actually yield less resources. The argument goes like this: budget endogeneity is such that tax contributions will fall if voters perceive that a small group is receiving most of the benefits; thus, aggregate spending on the poor will decline (see Gelback and Pritchett 1997). While this might justify a shift toward universal coverage over the medium-term, targeting seems necessary in the context of a short-term crisis, particularly when other budget constraints are already binding.

similar window of opportunity for social policy innovation. Instead, emergency targeted resources at the national level continue to compete with a broad range of other "blanket" programs operating in the provinces.[11] Below we further elaborate on these two cases with an eye toward understanding why economic crisis was a catalyst for social innovation in one setting and an apparent impediment in another.

Part II. The Country Experiences

Mexico

Distribution and the 1994-95 Crisis

The Mexican financial crisis of 1994-95 has spawned a variety of competing explanations, with some emphasizing problems in the banking sector and others more focused on what might be termed exchange rate fundamentals.[12] We tend to fall into the latter camp. As is well-known, the real exchange rate appreciated substantially over the Salinas *sexenio* (1988-94) under the thrust of a series of stabilization agreements negotiated between the government, business, and labor from 1987-1994 – arrangements that pegged the peso closely to the US dollar, but at a pace of depreciation insufficient to compensate for the difference in US and Mexican inflation. With relatively cheap imports swelling well beyond export capacity, Mexican policy makers talked a brave game, pointing to the balanced fiscal accounts and insisting, first, that the real appreciation of the peso was due to confidence in the Mexican economy; and second, that private financing via portfolio investment (mainly stocks and bonds) was sufficient to cover the rising trade imbalance.[13]

Underpinning this resistance to an increasingly necessary exchange rate adjustment, however, lay some old-fashioned politics. Although the usual suspects (outward-oriented producers and investors looking to export) had been clamoring for a more competitive exchange

[11] Authors' 4/04/03 interview with Claudia Sobron and Gabriel Martinez, Program Directors at SIEMPRO, Buenos Aires.

[12] See Gil-Díaz and Carstens (1997), Sachs, Tornell, and Velasco (1995), and Pastor (1998).

[13] For early critiques of Mexican bravado prior to the 1994 peso crash, see Pastor (1994) and Dornbusch and Werner (1994); for the technocrats' defense of their own strategy, even after it failed, see Gil Díaz and Carstens (1997). For one post-mortem which shows how such currency attacks can occur over a broad range of scenarios, including one of only modest imbalances and fairly sound fundamentals, see Rajan and Sugema (2000).

rate by the early 1990s – and this was certainly the policy that best fit Mexico's expressed goals to integrate more closely with the North American bloc – the Salinas administration opted for the political comfort and ephemeral stability of defending the peso-dollar peg.[14] The maintenance of an overvalued exchange rate appealed to a broad domestic constituency composed of financial, industrial, and consumer interests. By containing inflation and the cost of mounting dollar-held debts, and by superficially pumping up consumer purchasing power, the prevailing macroeconomic strategy may have been unsustainable in the long run. But it did position the PRI for an electoral victory in 1994, after a near loss six years earlier, and this was at least partly due to the enhanced purchasing power, easy domestic credit, and ready access to cheap imported goods that currency appreciation had afforded the electorate.

Given that red lights had been flashing around the Mexican peso in international financial markets since 1993's year-end economic indicators, the newly inaugurated Zedillo administration (1994-2000) pressed for an orderly devaluation in late 1994. Yet, almost unwittingly, Mexico had become the test case for the first "post-Cold War surge in securitized capital flows" to the developing countries since before World War I (Hale 1997). Institutional and individual investors alike, who held an unprecedented $34 billion in Mexican equities in 1994, simply fled as the Zedillo team made an initial attempt at a step devaluation. This led to the peso's free fall, a subsequent collapse in output, and a $50 billion multilateral bailout package assembled for Mexico in February 1995. Meanwhile, the recently privatized banks were shown to have made a huge number of bad loans, and the government was forced to step in and shore up the banking system with loan purchases that would eventually cost nearly 20 percent of GDP.[15] Stripped of any pretensions about a new and/or creative macroeconomic strategy, the government resorted to the old policies of depreciation to restore competitiveness; it also

[14] Elsewhere (Pastor 1998), we have explored why the inevitable adjustment was so stubbornly postponed. While economic factors played a role, politics and policy were also critical. In delaying the necessary currency adjustment, the Salinas administration avoided a downturn in import demand that might have threatened the passage of the North American Free Trade Agreement (NAFTA) by the U.S. Congress in late 1993. By the time devaluation was a potential policy option, the Zapatista rebellion in January 1994, the assassination of PRI presidential candidate Luis Donaldo Colosio in March 1994, and the subsequent mid-1994 presidential elections all intervened to render devaluation too much of a political risk.

[15] McQuerry (1999) points out that this cost, while high, was lower as a percentage of GDP than the bank rescue efforts in Argentina, Chile, and Uruguay in the early 1980s. On the other hand, these were all authoritarian regimes, whereas Mexico's bank costs were exploding just as the longstanding single ruling party was under intense pressure to democratize. For more on the aftermath of the bank bailout, and the pressures this placed on the public debt, see Giugale, Lafourcade, and Nguyen (2001, chapter 9).

managed to swell the primary fiscal surplus, allowing for the overall balance to remain at zero even as inflation and interest rates skyrocketed.

What surprised many critics of Mexico's so-called neoliberal project, particularly those concerned with the heavy costs the poor had paid in the wake of the 1982 debt shocks, was the fact that the 1995 adjustment program actually worked. After a sharp recession, the economy rebounded in mid-1996, led largely by an export boom. Having sworn off exchange rate fixes and tripartite pacts, the government nonetheless managed to reduce inflation below double digits by the year 2000. Private investment staged a rebound after a natural decline during the 1995 downturn, and by 1999-2000 it registered the highest share of GDP since 1970, the earliest year for which we have reliable data.[16]

Meanwhile the distributional variables took an unexpectedly positive turn. Table 1 offers the aggregate results for all of the household surveys that were conducted during the period of economic restructuring, running from 1984 to 2002. Figure 1 simplifies the presentation by grouping the household deciles into the top 20 percent, bottom 40 percent, and middle 40 percent; there, too, we draw lines indicating the 1984 shares as a sort of benchmark for thinking about inequality.

<insert Table 1 and Figure 1; all tables and figures at the end>

Although it seems sensible that distribution worsened between 1984 and 1989, as the country struggled with the aftermath of the debt crisis and a bout of high inflation (at least by Mexican standards), it is noteworthy that the Salinas boom from 1989 to 1994 was marked by continued relative gains for those at the top and relative falls for those at the bottom of the income pyramid. This pattern built on an already deep history of inequality: according to the IDB (1998: 25), Mexico ranks as the sixth most unequal country in the region in terms of the Gini coefficent for per capita household income.[17] And it created ample reason to attack at least the immediate results of the neoliberal strategy: After all, the market model was expected to better

[16] We have argued elsewhere that this was largely due to the structural transformation of the Mexican economy, now led by higher value-added exports with greater responsiveness to the exchange rate incentive (Pastor and Wise 2003a). For more detail on the transformation of Mexico's export sector, see Gereffi (2003). The investment data cited in the text come from *Trends in Private Investment,* a series maintained by the International Finance Corporation. See www.ifc.org/economics/data/dataset.htm.

[17] IDB data also show that Mexico's urban inequality is higher than that of rural areas; however, the IDB's comparison of rural and urban inequality is for total income that includes both monetary and non-monetary sources. It helps to remember that the poor in rural settings often receive considerable non-monetary income in the form of imputed rent for their modest land holdings, which raises their recorded total income.

reward skill and initiative; reductions in corruption and increases in transparency were meant to eliminate the incentives and opportunities for rent-seeking; and, the enhanced reliance on an export-led model was expected to raise the demand for unskilled labor and thereby benefit the poor. Given that the market was supposed to move Mexico up the ranks toward greater equality, perhaps after a short period of initial decline on this front, movement under Salinas seemed particularly unpromising.[18]

As the data suggest, however, there was a brief and somewhat surprising relative gain during the 1995 recession – or perhaps, better put, the poor took a smaller relative hit from the 1994 financial crisis. The relative gains between 1994 and 1996 quickly gave rise to a new cottage industry of research that sought to explain this more favorable shift (although not as large as the industry that sprung up to explain why most macroeconomists and international financiers had failed to foresee the peso crash). A first round of explanations held that the 1994 peso crisis caused a loss in capital and interest income that most affected those at the top. However, closer scrutiny of the 1994-96 trends suggests that this explains only a small portion of the pattern. More significant was the fact that those in the top twenty percent of the economic hierarchy saw their own labor incomes dwindle substantially, as they were disproportionately involved in services, finance and other high-end non-tradable activities (Lopez-Acevedo and Salinas 2000).

<insert Figure 1>

That the 1996 performance was anomalous was made evident when the 1998 data – the last to emerge before the 2000 elections – came out and showed a reversal of distributional fortunes. Figure 2 compares two end point observations (1984 to 1998). The record suggested a sizable relative gain for those at the top over the time period considered and a significant worsening of the income share for the bottom 40 percent of households -- but contrary to common wisdom, the largest relative losers were those in the middle of the distributional pyramid. Indeed, Figure 2 makes clear that the wealthy's increase of 5.35 percentage points in national income came from mostly the middle 40 percent.

<insert Figure 2>

This tapping of the working middle is partly because the poor were already scratching out a truly Dickensian existence, and hence there was more to skim off of the mid-range deciles.

[18] Behrman, Birdsall, and Székely (2000) find that one synthetic measure of the intensity of neoliberal reform is a significant up-front increase in inequality, which tends to decline over time.

Still, the trend helps to explain the heightened disaffection of middle class Mexicans with the ruling PRI party post-1994, even as the latter could continue to count on some loyalists among the urban and rural poor. And it also explain why the government used exchange rate appreciation, combined with looser access to personal credit, to help paper over middle class losses. By 1998, however, voters had lost confidence in PRI economic management, distribution was largely back to the dismal 1994 pattern, and the stage was set for a Fox victory.

Of course, some avid reformers might suggest that our focus on distribution issues *per se* might be excessive: slipping behind relatively is less painful if one is earning and eating more in absolute terms. In fact, distribution matters a great deal in Mexico. Between 1980 and 2002, the last year for which we have a distributional survey and reliable figures, real per capita GDP posted an average yearly growth rate of just .6 percent. This stagnation suggests that Mexico is still light years away from reaping East Asian-style income gains based on an export-led orientation and aggressive investments in human capital. In other words, when the pie is expanding so slowly, the size of the slice matters a great deal.

Because of this, it is significant that there were relative gains in 2000 and 2002 for those in the lower deciles. This pattern is also evidenced in the wage data offered in Figure 3. As can be seen, the higher wages of the pre-debt crisis period were sharply slashed by the early stabilization efforts of the 1980s. Although labor incomes did stage a recovery after 1989 under Salinas, the sharp run-up in wages during the Salinas *sexenio* seems to have meant little in the way of distributional improvements for the poorest Mexicans and may have benefited the middle and upper income groups, as Lopez-Acevedo and Salinas (2000) suggest. The peso devaluation of 1994 actually had a negative impact on manufacturing wage in 1995 and 1996, much like the slowdown that occurred in the early 1980s. Judging from the household survey information on distribution, the damage to the poorest income group was more limited in the second of these sharp recessions, suggesting that wage dispersion compressed somewhat during that period; in other words, the decline in the overall average wage may have been driven more by falls at the top and middle of the wage-labor spectrum, a fact which squares with longer-run trends in the distributional data.

<insert Figure 3>

The post-1996 recovery, however, did translate into continuing improvements in real wages, and these have persisted despite the onset of economic recession in Mexico since 2000,

marked by lackluster growth rates of -.3 percent and .9 percent in 2001 and 2002, respectively. Part of the reason seems to be that wage recovery now stems from the low-skill export sector, itself driven by a more competitive exchange rate, rather than from non-tradable services; it is the latter that continues to dominate Argentine labor markets, and this constitutes a major impediment for income improvements there.[19]

That these lower-wage export industries have brought improvements in worker incomes after devaluation may surprise the usual critics of *maquila*-led growth.[20] Note, however, Figure 4 in which we contrast the movement of the real wage in the *maquila* and non- *maquila* manufacturing sectors, with both normalized to 100 for the pre-peso crisis year of 1993. As the figure shows, the *maquila* wage performance has been relatively better. More recently, although *maquila* wages have held steady, this trend has been juxtaposed by the slowdown in exports and the shrinkage in *maquila* employment (see Figure 5). This reflects the movement of some lower end component-assembly industries to China and elsewhere, leaving only the relatively higher skilled and higher paid jobs behind in Mexico (Hanson 2003).

<insert Figures 4 and 5>

Of course, it is easy to make too much of these recent positive trends. Casting back to the long-view, we calculated the gross national income per capita, applied it to the changing distribution to determine the real income gains for an average household in each quintile, applied a discount rate of 3 percent to take account of the fact that income gains early in the period were worth more (if invested) than income gains recently, and calculated the income gain as a percent

[19] As the data in Table 1 make clear, 1998 brought relative deterioration for those Mexican workers at the bottom of the earnings structure; one hypothesis is that this reflected some recovery in the non-tradable sector as overall growth resumed and trickled through the rest of the macro economy (Acevedo-Lopez and Salinas 2000). Mexican wages fared better from 1999-2002, and the dynamism was apparently concentrated in the lower-skill export sector.

[20] Originally launched in 1965, Mexico's *maquila* program allowed duty-free imports of capital equipment for use in manufacturing and assembly, with the stipulation that investors pay duty only on the value-added within Mexico, and that 80 percent of a plant's output must be exported. Now nearly liberalized since the implementation of NAFTA in 1994, the *maquila* firms have become the locus of a rapidly transforming labor market in Mexico. Once the very image of exploitation and underdevelopment, Mexico's maquila sector now cuts both ways, as it has also become a main venue for upward mobility for those with the minimum skills to enter this sector (Gereffi 2003). This latter notion of a positive impact that increased trade may be having on income distribution in Mexico would seem to be at odds with the longer-term work conducted, for example, by Hanson (2003). He argues that those jobs created in Mexico due to trade and investment liberalization were relatively high-skilled by Mexican standards and thus drove up labor income inequality. However, these data do not fully account for the increased participation of female workers in the 1990s, and thus the expansion of income per household; nor do they include wages in agriculture, which rose relative to most other sectors in 1990 (Hanson 2003: 17).

of starting income.[21] The results, depicted in Figure 6, remind us of just how well the very rich did over the broader period and how problematic were the fortune of those just above the ranks of the very poor. The pattern should certainly temper any excess enthusiasm about the Mexican model.

<insert Figure 6>

Still, the recent pattern is noteworthy, particularly as it occurred in the wake of macroeconomic crisis. While wage improvements for semi-skilled workers in the *maquila* industries contributed to the relative upswing at the bottom between the pre- and post-devaluation periods (see the long-term patterns in Figure 1), the significant increase in the income levels associated with those in the very lowest decile may be at least partially attributable to the 1997 shift toward a social policy that more aggressively targets the poor. This shift is surprising in light of the political dynamics. Since the mid-1980s, meager gains for those in the middle deciles were overshadowed by huge increases for the already wealthy. The income flow from the middle was exacerbated by the financial problems of the mid-1990s during which new middle-class users of credit were hit hard by high interest rates and failing banks. With a hard-hit middle class at risk of fleeing the PRI, one would have expected the Zedillo administration (1994-2000) to return to the politics of the Salinas era: talk a neoliberal game while maintaining the loyalty of the poor through demand-driven safety-net spending coupled with tight political control. Instead, the Zedillo team, after some stumbles, reinvented social policy in a fashion that surprised many long-time observers of Mexico's political economy.

Distribution, Wages and Social Policy: Pushing New Reform Boundaries

The renovation of social policy in Mexico was not related to the financial crisis *per se* but rather emerged from a longer political and economic process; however, the crisis did help to open up the opportunity for a major shift in policy emphasis. Benign neglect in the face of severe distributional stress related to Mexico's 1982 financial crisis had nearly cost the PRI the presidency in the 1988 elections. Thus, immediately upon taking office in 1988 the Salinas

[21] A discount rate of three percent is well below the usual rate applied to cost-benefit analyses. Given the pattern of earnings by quintile over time, higher rates tend to reduce the estimate of gains at the lower end (since they were late in the period) and raise the gains of the wealth (who "won" most in the initial rounds of reform.

administration revamped poverty alleviation policies and the PRI's traditional patronage machine by creating a demand-based social safety net program called PRONASOL. The effort basically involved the concentration of adjustment support in the office of the executive, which then determined spending priorities in response to community-generated project proposals (He 2000). According to Cornia and Reddy (2001: 15), PRONASOL had the highest dollar payout per capita of any of a series of similar social funds created in those developing countries for which they could collect data; while this partly reflects the higher income status of Mexico, it is also testimony to the political priority that the Salinas administration had assigned to its safety-net strategy.

The programmatic logic of PRONASOL was attractive in its local and participatory character but analysts have readily pointed out that this sort of demand-driven model—in which the government funds local officials and organizations who petition for support—does not necessarily make for effective targeting in terms of poverty reduction (Graham 1994; Lustig 1998). Under such a scheme, only the most vocal and cohesive sectors are able to obtain resources, creating a bias in favor of those more organized groups and away from the poorest.[22] Such an approach also raises the potential for a program to be used simply as a tool of patronage and co-optation. Such were the accusations against PRONASOL by opposition parties and independent analysts, partly based on the high correlation between PRONASOL spending and electoral districts where the government party needed to shore up support---a fact that may help to explain the relatively high spending on the program.

The Zedillo administration, anxious to distance itself from the perceived failures of the Salinas era, transformed PRONASOL into a more targeted program called PROGRESA (Program of Education, Health, and Nutrition).[23] Just as Mexico's ambitious commercial liberalization of the 1980s was accomplished by literally moving trade policy out of the trade ministry (Pastor and Wise 1994), PROGRESA was similarly launched in late 1997, not from the social ministry, but from the Ministry of Finance. In more ways than one, PROGRESA represented a significant shift in Mexican social policy. First, was the Zedillo team's good-faith

[22] In reviewing a number of demand-driven social funds in various countries Cornia and Reddy (2001) note that the phenomenon of having "more and better project proposals coming from less poor communities" is a common one, owing to the greater technical sophistication and political savvy inherent in such communities.

[23] At the time, Mexico also had a temporary work program (PET, or Programa de Empleo Temporal)and a training strategy named PROBECAT. The latter was initially considered a great success but subsequent evaluations suggest that selection bias may have been driving the positive results (Wodon and Minowa 2003). PROGRESA has been subjected to much more rigorous evaluation procedures (Wodon et al 2003).

effort to extricate social policy from the tentacles of the PRI patronage machine.[24] Second, in that it is a supply-side approach to human capital investments, PROGRESA is a mirror image of PRONASOL's emphasis on demand-based compensation – and, as such, is less likely to generate organized political support. Third, PROGRESA's focus is the design of innovative strategies in the areas of health, education, and nutrition. For example, PROGRESA funds are delivered to families through mothers, with the explicit aim of insuring that aid will be spent on children. Aid is also contingent on children attending school and on regular family visits to local health clinics (Wodon et al 2003).

From the early returns, evaluation studies suggest that PROGRESA is making a significant difference in the lives of participants (IFPRI 2000; Skoufias 2001).[25] As of 2003, PROGRESA covered 4.2 million families.[26] Of these 4.2 million families, around 600,000 reside in poor urban areas, reflecting a new thrust away from what was initially a rural focus. For these families, school attendance is up, with researchers estimating around a one percentage point gain in the elementary schools and a very significant gain of almost six percentage points for female high school students. The potential impact on human capital formation is straightforward: Researchers estimate that if these attendance increases persist, the program would add .7 years of schooling for each participant. Given the low levels of academic achievement in Mexico and especially in rural areas, this represents an increase in the average educational level for eighteen year olds of almost 10 percent. [27]

It appears that PROGRESA has also had a direct effect on income. Top officials at Mexico's Ministry of Social Development (SEDESOL) readily acknowledge that it is difficult to disentangle the effects of the country's relatively high growth rates 1996-2000 from the policy effects of PROGRESA. Keeping this in mind, SEDESOL officials estimate that the program has

[24] This is not to say that Mexican social policy has somehow become free of politics or devoid of side-payments. Sadoulet et al (2001) note that the PROCAMPO program in Mexico, originally designed to compensate farmers who have lost price supports and are now subject to NAFTA competition, was driven by a desire to render trade liberalization politically acceptable. However, it has also managed to actually make a difference in the lives of the rural poor for a rather unusual reason: the cash flows have helped to relieve liquidity constraints and they have facilitated modest investments in enhanced production. PROCAMPO has also enabled producers to take more risks with higher-yielding investments thanks to the security provided by this income transfer (World Bank 2003).

[25] For a more journalistic assessment,see Alan B.Krueger, "Putting Development Dollars to Use, South of the Border," *New York Times*, May 2, 2002.

[26] This information is based on our 3/20/03 interview with Miguel Székely, Under-Secretary of Social Development, Ministry of Social Development (SEDESOL), Mexico City.

[27] Some high-level officials have confessed that another reason to introduce PROGRESA as a way of bringing parents, children, and schools on board was to bypass the Secretariat of Education where unions have long held sway and become more of an impediment to the kinds of rapid educational gains that PROGRESA seeks to foster.

lowered poverty by nearly 8 percent in the areas where it operates and has reduced one government measure of the severity of poverty (which takes into account not simply whether one is below the poverty line but how far below it, and then gives disproportionate weight to the poorest of the poor) by a startling 45 percent (SEDESOL 2000: 16). The macro-level evidence from the 2000 distributional survey may also reflect this gain. Again, whether this reduction in poverty is entirely due to larger macroeconomic and labor market dynamics, or reflects the successful targeting by government authorities, remains an open question. In this context, it is useful to note that PROGRESA's spending, which includes administrative costs, amounts to less than one percent of Mexico's GDP.

Although social policy is clearly moving in the right direction, the 2000 electoral returns and the PRI's loss of the executive office for the first time in some seventy years signaled that the underlying causes of Mexico's income disparities still needed to be more aggressively tackled (Pastor and Wise 1997). A key factor, increasingly important as liberalization has attracted more sophisticated kinds of foreign direct investment and growth has been driven by higher value-added exports, has been the rising disparities in the return to education (and not simply the disparities in education themselves; see Acevedo-Lopez and Salinas 2000: 9, 12, as well as Cragg and Epelbaum 1996).[28] Thus, PROGRESA's effort to directly address this educational disparity by directly tying social support to enhanced school participation is a crucial first step. However, the country's skill challenge is not just limited to the poorest 40 percent of workers: There also remains a dire education/skills gap for those income earners in the middle 40 percent who have suffered the largest losses over the long run since 1984 (see Table 1). Government policy had largely failed this group, as reflected in the election of opposition candidate Vicente Fox on the National Action Party (PAN) ticket in 2000.

Despite the political difficulties that Fox has encountered in ushering his ambitious reform agenda through the Mexican Congress (Pastor and Wise 2003b), not to mention the drubbing his own PAN party took in the July 2003 mid-term elections, important headway has

[28] While the higher returns to education may partly result from technological changes, internationalization may also be playing a role. Hanson (2003), for example, offers econometric evidence that tariff reductions may have dampened relative wages in low-skilled industries, thus contributing to wage inequality in Mexico. However, as discussed in an earlier note, the evidence above indirectly suggests that there may now be a return to demand for unskilled labor after the one-shot adjustment of tariff reductions has been absorbed; this would seem to bode well for the future. Cortez (2001) also points to the effects of institutional changes, including unionization and the minimum wage, on workers' bargaining power.

been made in launching a "second phase" social policy initiative.[29] As of 2002 PROGRESA has been wrapped into a new program called "Oportunidades," and the prime purpose of the latter has been to expand the coverage of targeted human capital investments into the middle classes and into poor urban settings, as both PRONASOL and PROGRESA were largely weighted toward the alleviation of rural poverty (with PRONASOL driven more by the politics of vote-getting in those areas and PROGRESA driven by a sense that poverty was both most concentrated and most tenacious in the countryside).[30] Those eligible for Oportunidades funding can benefit in a number of ways that extend the innovative nature of the earlier PROGRESA program.[31] For example, ninth grade students begin earning cash credits that they can draw on in various ways upon completion of the twelfth grade. If they choose to pursue a university education they can draw on the cash credits as a scholarship; or, if they opt to start a new business or invest in home improvements, they can use the cash credit as collateral to borrow at least three times the amount that has accrued. Finally, the cash credit can also be used to purchase a family health insurance policy that offers coverage for up to four years.

What is important from the point of view of financial crises and their distributional aftermath is the recent expansion of the program into urban areas. Both theory and evidence suggest that currency crashes may hit the urban poor harder, as they are more reliant on the monetary economy. The rural poor also suffer, but may be more able to retreat to some degree into self-subsistence (although given their increasing integration into wage-labor markets, this distinction may be fading). PROGRESA's initial thrust, however, was entirely rural. This may have made sense ten years ago when seventy percent of the poor resided in rural areas; however, the poverty population is now evenly split between urban and rural, partly reflecting internal migration.

Counterfactual analyses conducted by consultant working with Mexico's Ministry of Finance have confirmed that if the appropriately targeted social policy instruments had been in place prior to the 1994 crisis, the adverse distributional impacts would have been much less

[29] Of course, further progress on any social agenda will require a successful increase in tax pressure, a central concern of the Fox administration; see Pastor and Wise (2003b).
[30] This expansion was facilitated by a January 2002 $1 billion loan from the Inter-American Development Bank.
[31] Authors' 3/20/03 interview with Miguel Székely, Under-Secretary of Social Development, Ministry of Social Development (SEDESOL), Mexico City.

severe.[32] Now, with the expansion of PROGRESA-style efforts into the urban areas, and its commitment to vigorously invest in human capital improvements,[33] Oportunidades offers the necessary policy instruments to keep progress moving even during the next slowdown. When eventually coupled with a forthcoming and badly needed fiscal reform package in Mexico, Oportunidades also has the potential to provide a vital counter-cyclical social cushion in the face of future financial stress.

We do not seek to make too much of Mexico's programmatic shift, the accompanying social investments, and the distributional improvements noted here: these are all modest in terms of the remaining unmet needs and the country's own history of sharp inequality (recall, for example, the long-term relative gains depicted in Figure 6). Still, few would dispute that Mexico is finally on a more distributional track and one not dependent on the manipulation of relative prices to instill a false sense of prosperity. Moreover, the fact that this shift has occurred at all is remarkable in light of the usual pessimistic view of Mexican politics and power (Whitehead 1998) – a point we return to in the final section of the paper. First, however, we detail and compare the Argentine experience with distributional fallout and social policy responses in the context of its recent crisis.

Argentina

Distribution and the 2002 Crisis

The details of the Argentine financial crisis have been debated extensively, including sharp disputes over the role and responsibility of the IMF in exacerbating this crisis. At the risk of over-simplification, two competing explanations continue to swirl around this case, one that focuses on the excesses of fiscal policy and the other on the unsustainability of the fixed exchange rate (see Mussa 2002; Frankel 2002; Hausmann and Velasco 2002). Others have tried to walk a finer line, arguing that these two "murder suspects in the Argentine plot" were not

[32] Authors' 7/09/03 interview with Evelyne Rodriguez, former director of the social policy budget in the Ministry of Finance, Mexico City. For a detailed analysis, see Davis, Handa, and Soto (2003).

[33] In terms of broader investments in human capital, even though total programmable public spending has been reduced by about 5 percent since 1994, social spending per capita was 19 percent higher in 2001 than it was in 1994 (Levy 2001: 27-34). Within this category, health spending increased by 17 percent per capita from 1994-2001, while health spending for the uninsured in the lowest income deciles increased by 67 percent. Spending on education has increased overall by 24 percent since 1994 and there has been a shift toward primary education.

viewed with great alarm prior to the actual meltdown (particularly the exchange rate), and so political gaming and expectations must be brought more explicitly into the picture (Galiani et al 2002).[34]

As with our analysis of the Mexican case, the focus here is on how distributional concerns worked to delay an exchange rate and fiscal adjustment when the writing was so clearly on the wall, as well as the behavior of key social variables before and after the 2002 crisis finally exploded. Although the Argentine story is perhaps every bit as familiar as the Mexican one, such familiarity tends to breed a sense of "shock and awe" that the fundamentals could have deteriorated to the point of a debt default. In this analysis, we make no claims at offering a full explanation of the crisis or a complete account of the consequences, many of which are still extant. Rather, we offer an analysis of the distributional factors at play, both prior to and in the wake of the 2002 devaluation. In line with our consideration of Mexico, we also probe the possible relationship between economic crisis and a shift in Argentine social policy.

Earlier in the paper we pointed to the role that a fixed exchange rate played in ending Argentina's 1989-91 bout of hyperinflation, itself a reflection of the cumulative distributional struggles that had plagued the country over the entire post-World War II era. Despite its rich array of natural resources and its well-educated population, until 1991 Argentina was perhaps best known as a country that had ranked amongst the world's wealthiest nations a century ago, only to have fallen precipitously behind (Bulmer-Thomas 1994). Thus, the propensity of the electorate to rally around a fixed exchange rate under a currency board – an arrangement that has been prescribed primarily for small, open economies with flexible labor markets, none of which fits Argentina's description (Williamson 1995) – must be interpreted in this light. For example, in contrast to Mexico's buoyant post-World War II expansion under a model of "stabilizing development," or Brazil's "miracle" years of the 1960s, Argentina had long remained mired in low growth, high inflation, and chronic fiscal deficits.

Desperate for a way out, not only did the 1991 Convertibility Plan and currency board provide a welcome respite from a hyperinflationary war of attrition, this strategy also produced highly favorable results according to both Argentine and regional standards. Apart from a successful stabilization, Argentina's GDP growth averaged 4.7 percent from 1991-2000, while

[34] In terms of expectations, Hausmann and Velasco (2002) refer to the phenomenon of "self-fulfilling pessimism."

per capita GNP averaged 5 percent growth over this same time period.[35] These trends were second only to Chile and well ahead of Mexico and Brazil. Healthy growth and low inflation were two strong reasons for maintaining the fixed rate, but what about those in the tradable sector whom invariably bear the costs of exchange rate appreciation? In Mexico, it was precisely this lobby, energized by the passage of the 1993 NAFTA bill and by the prospects of intensified trade with the U.S., which became especially vocal in demanding a more competitive exchange rate. Interestingly, even in the wake of the "tequila shock," or financial contagion from Mexico's 1994 crisis, a pro-devaluation coalition was nowhere to be found in Argentina.

This seemingly simple political economy puzzle offers up no easy answer. Given the country's volatile past, and the first stint of high sustained growth in decades, producers and consumers alike were understandably reticent to rock the boat. However, as Figure 7 shows, the country's social indicators were already hitting stormy waters under the Convertibility Plan. In other words, the social side of the Argentine crisis was a long time in the making. After an initial improvement in employment when the Convertibility Plan was first introduced in March 1991, unemployment rose steadily through the course of 1990s. Initially lauded as a sign of labor productivity increases related to liberalization, privatization, and the downsizing and modernization of companies, Argentine unemployment hit a new high in the throes of the tequila shock.

<insert Figure 7

Although labor markets briefly rebounded with the rest of the economy by 1996, Figure 7 confirms that poverty rates climbed steadily from that point on. Nevertheless, the general air of recovery seemed to induce an unrealistic optimism that another chapter had been turned on Argentina's unstable macroeconomic past. Moreover, the perception that all sectors were sharing in the benefits from growth and stabilization – even if they were, as we will see, quite unevenly distributed – helped keep a historically militant labor movement and highly mobilized civil society more or less in check.

To give credit where it is due, the interim between the 1995 Mexican shock and Convertibility's grand finale in January 2002 saw some heroic efforts at reform completion and consolidation in Argentina, including the implementation of a deep financial sector restructuring

---

[35] These figures are based on the World Bank's *World Tables CD-ROM* 2000 and 2001.

(Alston and Gallo 2002), vigorous banking and tax measures, and Argentina's integration into the Southern Cone Common Market (Mercosur). Thanks to these efforts, policy makers were able to survive additional external shocks from Asia (1997) and Russia (1998). However, the very survival of these episodes had the unfortunate effect of reinforcing the sacrosanct nature of the convertibility regime. Some policy makers insisted that "sticking" with the approach was the secret to riding out the various shocks, while others stressed the longevity of peso-dollar parity as evidence of its health.[36]

Yet the immediately destabilizing effects of the Brazilian devaluation of January 1999 on the Argentine economy should have shed doubt on this hopeful scenario. Unlike the previous challenges to Convertibility in the 1990s, which had all hit the Argentine economy through the financial system, the main transmission vehicle for the Brazilian shock was the real economy. The expansion of Argentine exports into the Brazilian market (attributable to the earlier appreciation of the Brazilian real against the Argentine peso) had been important for Argentina's 1996 recovery and subsequent growth. Tellingly, Argentine exports to the Brazilian market rose to some 30 percent of total exports, three times the share headed to the U.S., the economy to which the peso had been tightly linked, and nearly twice the share headed for Europe. In early 1999, the Brazilian devaluation provoked a dramatic real appreciation of the Argentine peso, even as the Euro slipped against the dollar (see Figure 8).[37] Partly as result, the economy continued to stagnate and as Figure 9 shows, eventually collapsed.

<insert Figures 8 and 9>

With industrial production shrinking and the current account deficit approaching 12 percent of GDP, all of the country's positives were now deemed negative (Wise 2000: 103-104). Although multilateral and emerging market analysts alike had declared the country's fiscal accounts and short-term public debt to be manageable in late 1998,[38] these were now diagnosed as problematic; the country's total external debt, admittedly high at 50 percent of GDP, went from serviceable to excessive; finally, Argentina's export performance, never especially dynamic

[36] This was the general tone of our interviews conducted with a range of frontline Argentine policy makers in Buenos Aires during April 1998.

[37] Perry and Serven (2002) suggest that the Argentine peso was overvalued by more than 40 percent as of 2001; we argued several years before that the overvaluation may have been on the order of 25 percent (Pastor and Wise 1999)

[38] Argentina was, after all, the first emerging market country to return to international capital markets after the 1998 Russian default.

at 8-9 percent of GDP, was now portrayed as under-achieving and too dependent on mercantilistic sectoral pacts that had come to life under Mercosur (O'Keefe 2003).

As was the case with the Mexican exchange rate in late 1993, red lights were now flashing in international markets around Argentina's monetary regime. Something clearly had to be done, but what? Certainly not an exchange rate adjustment, some argued: Having stuck with the peso-dollar fix all through the volatile 1990's, why adjust the rules now? Indeed, while the tequila shock had presented its own opportunity to adjust the exchange rate, the shadow of a hyperinflationary past and the newfound influence of powerful actors in the financial and services sectors that benefited from currency appreciation had effectively foreclosed this option.[39] Moreover, it was noted, the currency board legislation simply prohibited devaluation. However, this failed to acknowledge that these rules, and reserve requirements in particular, had been flexibly applied at other crisis points. More persuasive factors for resisting devaluation included the high levels of dollar-held debt that had been incurred by the public and private sectors, and the obvious inflationary consequences for a country with a justified inflation phobia. To these explanations, we would add and emphasize the role of distributional concerns, i.e., the wrath that politicians sought to avoid from income earners and asset holders at all points along the income pyramid (Frieden, Ghezzi, and Stein 2001).

The saga of President de la Rua's early resignation in December 2001, and the five successive presidential rotations that followed, was at heart a battle over which groups and sectors would bear the burden of adjustment. True to Alesina and Drazen's (1991) model, all sides lost, but it is the poor that have taken the biggest hit of all. This is evident in Figure 7, which shows that poverty was actually quite high at the outset of the Convertibility Plan, mostly because of the regressive impacts of hyperinflation and its aftermath. What is disheartening is that the current poverty rate – more than a decade into the reform effort – is as high as it was during that earlier hyperinflationary period. Similarly, with the downturn that began in 1999, unemployment spiked back above the drastic highs of 1995, peaking at 22 percent in mid-2002,

[39] We stand by our earlier argument that it was artful policy management, rather than sound fundamentals, that saved the day in 1995. Hindsight readily shows that Argentine policy makers should have exploited the credibility gained from their deft handling of the tequila episode, and used this policy leeway to slowly slip off the dollar-peso standard before disaster inevitably struck (Pastor and Wise 1999). Eventually, Finance Minister Cavallo attempted to do just that by proposing a complicated fiscal devaluation, with import tariffs and export subsidies meant to offset the appreciation of the peso against the euro; but by this time, credibility was lost and the scheme was seen as a transparent attempt to abandon commitments. See Hausmann and Velasco (2002).

before a moderate recovery in the year that followed (our last data point on unemployment, shown in Figure 7, is for May 2003).

As for the distribution of income, the pattern is equally distressing. Figure 10 shows the ratio of the share of income held by the top ten percent of households to that held by the bottom ten percent, as well as the share of income held by the top twenty percent relative to that held by the bottom forty percent; the last observation for this series is for October 2002.[40] With some modest variance, there was steady distributional deterioration throughout the course of the Convertibility Plan. This trend turned even more regressive after the January 2002 currency crash itself, particularly for the performance of the bottom ten percent of income earners relative to the top ten.[41] Still, the important point here, and one emphasized by Frenkel (2002: 51) as well, is that the "dramatic impairment in labor indicators and in income distribution was not the result of the final crisis of the macroeconomic regime of the 1990s in Argentina, but preceded it."

<insert Figure 10>

Of course, distribution might not be of central concern if income were improving in absolute terms for those at the bottom of the income pyramid. Figure 11 averages the trends and looks at the relative growth in real income for the bottom twenty percent, the middle forty percent, and the top ten percent following a procedure similar to that employed earlier for the Mexican data. We divide the Argentine distributional data into three periods: 1991-94, the stellar moment for Convertibility; 1995-98, as Argentina rode out the tequila and various other external shocks; and 1999-2002, as the economy deteriorated in the wake of Brazil's January

[40] Our analysis of income distribution in Argentina is based on the per capita household income series for Gran Buenos Aires, partly to be consistent with earlier data collected and presented in Pastor and Wise (1999). This is also the series, albeit for the nation as a whole, used by Damill, Frenkel, and Maurizio (2002) and in World Bank (2000). Our simpler presentation of trends squares with the upward regressive movement of the Gini coefficient calculated by Damill et al (2000); our finding of modest improvement between 1992 and 1994 and steady deterioration afterwards also matches those calculations. We should note that we only present the data for October of each year to avoid seasonal variations and to reduce volatility in the displayed series; we use the May observations in the regression analysis discussed in the text. We also smooth the 1989 inflationary observation by taking the average of May and October for that year.

[41] One policy move that may have had a positive effect in a distributional sense is the conversion of bank loans into pesos at a rate of one-to-one in January 2002. This means that small borrowers on both the consumer and business side have been able to service loans while bigger companies with dollar debts are facing stiffer challenges. Of course, this has come at the cost of a strained banking sector which will eventually have regressive effects in terms of employment growth and bailout costs. As noted earlier, the distributional impacts of this implicit wealth transfer are complicated and merit a separate paper; our focus is on the traditional dimensions of income distribution as usually framed by proposals regarding social policy.

1999 devaluation. As can be seen, the wealthiest actually posted declines in the most recent period, particularly in contrast to the spectacular gains shown when comparing the 1995-98 period to 1991-94. But the lower end of the spectrum experienced only modest gains from 1995-98, and sharp declines in the most recent period.

<insert Figure 11>

To what extent is the increase in poverty in Argentina a result of rising unemployment and to what extent is it a function of the changing distribution of income? One simple estimate involves regressing the poverty rate, first, on unemployment and then on the distribution of income, a procedure similar to the techniques employed by Damill, Frenkel, and Maurizio (2002). For both regressions, the unemployment variable is insignificant while the distributional measure we derive, the ratio of the top 10 percent's share of income to the bottom ten percent's share, is quite significant and the adjusted R-squared is high.

However, as Damill et al (2002) suggest, employment patterns themselves can explain distribution. In other words, unemployment depletes income flows for those at the bottom, both through the reduction in earnings for those not working and in the loss of bargaining power and downward wage pressures for those with jobs (Frenkel 2002). To get at this, we took a recursive approach, taking the residuals from a regression of our distributional measure on the unemployment rate, and then entering those residuals---as a proxy for the change in distribution not accounted for by employment changes---as a regressor along with unemployment. While a more complicated and perhaps simultaneous model might be preferred, this strategy does reflect a recursive process and should bias us against finding an impact of distribution *per se*.

As it turns out, both variables are signed as expected and now significant (with the distributional variable achieving the .01 level and unemployment rate the .05 level). These results suggests that wage changes for those at work were also quite significant, a fact confirmed by the alternative method used in Damill et al (2002) to net the unemployed out of the distribution, as well as the attempt of World Bank (2000) researchers to disentagle the income effect from the distribution effect in calculating national poverty rates. World Bank (2000: 17) also notes that a move of Argentina to full employment around the end of the last decade would have trimmed poverty very modestly, from about 19% to 23%, once again suggesting that the distributional issues were key.

What other factors drove this negative distributional shift? Frenkel (2002) points to the privatization of natural monopolies in the absence of sufficient regulatory oversight, to which we would add that shifts in returns to skill in utilities and services played a large role as well.[42] As noted by the World Bank (2000:61), over the 1990-98 period, professional incomes rose by 53% in Argentina, while wages for skilled workers rose 13% and those for unskilled workers fell by 3%. Galiani and Sanguinetti (2000) find that trade liberalization also accounted for a portion of the increase in wage disparity, but the pattern is almost a reverse of Mexico's: for the latter, the skill premium rose for the production of high value-added tradable goods, especially after the 1994 devaluation. In Argentina, trade liberalization under a fixed exchange rate shifted the demand for skilled workers into the non-tradable sector, leaving unskilled workers with shrinking income and employment options in a tradable sector led by energy and agricultural exports.

Some have suggested that a more far-reaching labor reform program would have raised the demand for unskilled workers and helped ameliorate this bleak distributional picture. Such reform was admittedly stymied in any far-reaching way by the Peronist majority in the Argentine congress. Ironically, in the guise of protecting the losers under a fixed exchange rate, Peronist legislators inadvertently froze their low-skilled labor constituents out of the domestic job market. Then again, we question whether the impact of labor market "flexibilization" on distribution would have been all that favorable, particularly given the role that some institutional floor can have in increasing bargaining power and hence maintaining wages in the lower rungs of the labor market (Cortez 2001).[43] Even the World Bank notes that labor reform in Argentina could have skewed distribution further by allowing a decline in the market-clearing wage, arguing that "the impact of labor reform, could in the short run, increase poverty. However, for labor market flexibility to reduce poverty, one must assume that these reforms increase incentives to invest over time, and thus increase the demand for labor" (World Bank 2000:24). Given the increasingly distorted economic structure fostered by overvaluation, the necessary investment incentives were anything but certain. Thus, as early as 1995 when unemployment first

[42] There was also an increase in business concentration, with one study suggesting that the top 100 firms controlled 46.5% of industry in 1997-98, up from 37.2% in 1991-93 (Lozano and Manjovsky 2001).

[43] There was a piecemeal labor reform package mandated through executive degree by President Carlos Menem but this still left the broader labor system largely intact.

skyrocketed, the more economically efficient remedy- a competitive devaluation – was at odds with powerful interests that now controlled domestic politics.

What is fascinating is that the steady regressive shift in distribution over the lifetime of the Convertibility Plan did not provoke severe political conflict until the very end, especially in light of Argentina's volatile past. Of course, once the middle classes and popular sectors had reverted to past behavior, i.e., taking to the streets and banging pots and pans in protest of holiday time capital controls announced in December 2001, the executive was literally forced to resign and more populist politicians stepped to the fore. In our view, what held populist forces in check for so long, particularly given the unmistakable distributional downturn, was their prospective "buy in" to the overvalued exchange rate. In retrospect, and as Figures 7 and 9 showed, Convertibility's heyday was brief; yet, the electorate overall was more willing to hang on indefinitely to the sense of stability and appreciation-induced purchasing power that marked the 1991-1994 period than it was to ponder a return to the inflationary past. In essence, until the bitter end, the kinds of distributional tensions that would have traditionally provoked civic mobilization were masked by prospective hopes that the prosperity enjoyed from 1991 to 1994 could be recaptured.

We might add that such domestic optimism was fueled by a kind of "war of the worlds," in which the external sector and creditors continued to pick up the tab for adjustment. But by 2001, such adjustment seemed increasingly unlikely, be it in political or economic terms. For example, Finance Minister Domingo Cavallo's July 2001 announcement of a "zero-deficit" policy was meant to garner confidence by signaling that the gloves had finally come off in terms of the government's commitment to carry out a program of fiscal austerity. Despite the distributional fallout, pensioners and state employees would be forced to take an income cut of 13 percent, and the provinces would finally be forced to kick in their share. As Hausmann and Velasco (2002) point out, international markets were by now unimpressed and the risk spread quickly rose. Now exposed, the myth of Convertibility was no longer a credible strategy for imposing adjustment costs; the "war of attrition," suppressed on a domestic level for a decade, quickly escalated and collapse soon followed.

The Political Economy of Social Policy: Impediments to Reform

Of course, the Argentine government was far from immune to the mounting political pressures, economic realities, and social risks inherent in the Convertibility Plan. In terms of political survival, witness Menem's fiscal loosening toward the late 1990s, a ploy meant to both distract the electorate from its increasingly distributional mood and to buy up the support necessary to launch his move to run for a third, albeit constitutionally contested, presidential term. The Menem team kept a close eye on the rising unemployment figures and the administration's concern heightened with the upward leap in job losses that registered in 1993 (see Figure 7). This led to the creation of a new Ministry of Social Development that had the explicit mandate to tackle unemployment, as Argentine labor markets continued to contract.[44]

But this first step toward policy innovation constituted a social strategy that was directed not toward bridging the country's distributional gap via supply-side investments, but rather toward the lessening of short-term adjustment stress around employment issues.[45] The government, akin to the logic that underpinned PRONASOL in Mexico, was more concerned with political palliatives than with seriously tackling the distributional problem.[46] Despite the proliferation of dozens of small separate programs in health, education, nutrition, and employment relief (World Bank 2000), the country's social strategy has continued in this fashion despite the alarming rise in poverty rates and inequality over the past decade.

As for overall resources devoted to the effort, Figure 12 shows that social spending (which includes expenditures on health, education, social insurance, and some urban services) was maintained in real terms even as GDP was falling – at least until 2002. Yet, what the Argentine government labels as "focused" or "targeted" spending on the poor – programs that are specifically aimed at those who fall below the poverty line rather than in the universal benefits category – actually dropped in both real and relative terms (see Figure 13) as the

[44] For an overview of Argentine social policy prior to the 1990s, see Beccaria and Carciofi (1995).

[45] Authors' 4/04/03 interview with Claudia Sobron and Gabriel Martinez, Program Directors at SIEMPRO, Buenos Aires.

[46] This becomes evident when the various categories of social spending are scrutinized. For example, the World Bank (2002: 30) reports that the targeting of housing expenditures was "weak" with only 22 percent of funds under the main assistance program going to the poorest 20 percent of the population. The Bank even argues that because of low interest rates and low repayment rates, the loans disproportionately benefited middle-class borrowers. There are numerous other gaps in the Argentine safety net; the World Bank (2000: 28), for example, estimates that 55 % of the elderly urban poor do not receive any pension support whatsoever.

economy was slipping into economic depression from 1999 to 2001.[47] The pattern against suggests political payoffs rather than attempts at real poverty reduction.

<insert Figures 12 & 13>

Nor is the recent "improvement" in targeted spending (as a percent of total social spending) in 2002 as significant as it might appear at first glance; part of what seems to have driven the shift in targeted spending is the movement of beneficiaries out of programs that offer universal coverage and into the targeted programs, as these same beneficiaries fell below the poverty line and hence became eligible for targeted rather than universal social assistance. This pattern of downward mobility was earlier evidenced in Figures 6 and 7; Figure 14 confirms that social spending per poor household actually fell considerably between the 1997-98 period and actually hit abysmal lows in 2002, exactly when it was most needed.

<insert Figure 14>

Casting back to the longer term trends, it is important to note that there was also a shift in who was responsible for social spending in at least two respects. First, net of social security, there was a dramatic shift during the Convertibility era with responsibility for social spending decentralized to the provinces. As Figure 15 indicates, after being lower in real terms than at the federal level during the early 1980s, provincial social spending first tracked along with federal spending, then began to swing upwards at an increasing rate. A seemingly legitimate strategy of decentralization, and one endorsed by the multilateral lenders in the wake of the tequila shock, this provided the perfect shill for the de facto provincial safety-net that we mentioned earlier.

<insert Figure 15>

This leads in to our second point: payoff-style social spending began to be hidden in the provinces, as payrolls were padded to quiet the social tensions emerging from rising unemployment and deepening inequality. This is at least part of the explanation for the increased share of social transfers to the provinces; the government, lacking an effective safety-net strategy in the wake of the tequila crisis, instead simply transferred more money to the local level (see Figure 16). This, of course, had the added advantage of purchasing political support for those Peronist party leaders that dominated the majority of provincial governorships (Alston and Gallo

[47] We refer here to the more generous definition of "focused" social spending used by the relevant Argentine agency, SIEMPRO; the World Bank (2000) offers a series that suggests a percent of spending on the poor that is around half of that reported by the Argentine authorities.

2002; Faucher and Armijo 2003) and were instrumental in controlling party lists and candidate selection at large; but it hardly constituted a targeted social policy proper.

<insert Figure 16>

The capacity of the provinces to run large deficits and to extract central government financing to cover their chronic fiscal gaps is rooted in part in the fact that Argentina has one of the most decentralized public sectors in the region (Garman, Haggard, Willis 2001). In contrast with Mexico, where state governors are still kept on a very tight leash regardless of party affiliation,[48] more than two-thirds of non-pension public spending is controlled by the provincial and municipal governments in Argentina. At a deeper level, the independence of the provincial governors and the central role they play within the political parties has perpetuated their ability to simply rise above the usual demands for fiscal discipline. Indeed, provincial governments had grown so accustomed to bailouts from the federal authorities that they simply issued quasi-money when bailouts have not been immediately forthcoming.

Tomassi et al (2001) present an elegant model of this fiscal standoff.[49] While the math might be complex, his message is simple: if inter-temporal arrangements are difficult to enforce, this will lead to policy volatility (as various agents jockey for position) or excessive policy rigidity as all agents seek to protect themselves against capricious behavior. The latter was precisely the role played by the Convertibility Plan. However, as the Plan's credibility gradually waned in the late 1990's, political tensions festered beneath. As Tomassi et al (2001: 167) note, "some provinces accumulated arrears of up to six months in payments of public salaries" (hence the need for quasi-money). Convertibility locked in agents' hopes that payment would eventually be forthcoming and made them more willing to wait out the "war of attrition" in expectation that the cash would finally arrive. When Cavallo's surreal "zero-deficit" policy came down in July 2001, zero-sum politics instead erupted in typical (pre-Convertibility) Argentine fashion.

Amidst this political economic aura of false comfort, at least one Argentine employment-based program has achieved international recognition as a "pro-poor" policy: the Trabajar program. Introduced in 1996 in the wake of the tequila crisis, Trabajar is essentially a community-based make-work project. The first version was like PRONASOL – demand-based

---

[48] Authors' interviews with three Mexican state governors (Governor Manuel Nuñez Soto, Hidalgo; Governor Francisco Ramírez, Jalisco; and Governor Ricardo Monreal, Zacatecas) conducted in Mexico during July 2003.

[49] See Benton (2003) for a more straightforward political explanation based on the structure of obtaining party loyalty in Argentina; Tomassi et al (2001) undertake the more ambitious task of building a quantitative model in which the very "rules of the game" are explained.

and captured by the more organized groups operating in the country's politically powerful provinces and cities. A second version of Trabajar attempted to allocate resources more directly to the poor. With this programmatic shift, the World Bank estimates that 40 percent of Trabajar's resources have benefited the bottom 5 percent of the income pyramid, while 75 percent reached the bottom 20 percent. However, Ravallion (2002a) also cautions that Trabajar is quite vulnerable to fiscal retrenchment.

Trabajar's most recent incarnation is a part-time work program called the Plan Jefas y Jefes de Hogares Desocupados. Also a make-work plan, the government claims a relatively high degree of targeting, with nearly 67 percent of the beneficiaries falling in the poorest fifth of households and another 27 percent in the second poorest fifth. And it has been effective in its own way: in Gran Buenos Aires, the government estimates that the unemployment rate would have been five points higher in October 2002 had it not been for the Plan.

But it is important to stress that the Plan is not only make-work, it is part-time work. The average work week under the Plan is twenty-five hours and 70 percent of the recipients work twenty hours a week. Because of this part-time focus, the program has had little positive effect on the increasingly important problem of underemployment – defined in Argentina as involuntarily working less than 35 hours a week – and underemployment seems to have taken the place of unemployment (see Figure 17). And because because the wage rate associated with the Plan is so low, it has had an extremely modest impact on poverty – reducing the poverty rate by about half a percentage point – although it has had a more substantial impact on reducing indigence.[50]

<insert Figure 17>

In the meantime, both the World Bank and the Inter-American Development Bank made funds available in March 2003 for ameliorating the distributional effects of the crisis, including monetary transfers, funds for medicines for the very poor, PROGRESA-style payments to keep

---

[50] The government estimates that the poverty rate for those households in metropolitan Buenos Aires who are beneficiaries of the Plan is 95.3 percent but would be 98.3 percent in the absence of the subsidy. If we take that number of households, it amounts to about .6 percent of all households in Gran B.A.; thus, the poverty rate was reduced from 42.3 percent to 41.7 percent. The impact on indigence was such that the indigence rate for households fell from 16.9 to 14.1. These calculations are perhaps more generous than they should be – the government's report of covered households is about twice that provided by independent observers but we use the government's less modest figures here. The impacts on indigence should also be contextualized by noting that the price index for a basic food basket has risen by 77% between December 2001 and January 2003, while the more general basic consumer basket rose by only 58% and the wholesale price index rose by 43%.

indigent children in school, and some basic infrastructure improvements in the most marginal neighborhoods. Still, resources are short, social policy is remains highly fragmented, and a Mexican-style esprit d'corps does not appear to be waiting in the wings to take up the challenge of social policy innovation. In terms of our analysis, Argentine social policy remains mired in its own war of attrition; more than a year after the severe financial crisis, and to everyone's detriment, all of the key economic actors continue to face each other down in this arena as well as others.

Although policy makers acknowledge the need for a complete overhaul of the country's social policy and the streamlining of multiple and dispersed budget lines into a focused short-run safety net strategy, failure to fully exit the crisis has slowed progress on this front. Yet both the Mexican case and general political economy theory suggest that simply waiting for recovery is not enough: designing the proper social instruments now will be essential for helping fend off future cyclical shocks, as well as for mitigating the distributional impacts when they do occur.

Part III. Comparative Insights on the Political Economy of Policy Reform

In this paper we have explored the general impact of currency/financial crises on distribution, coupling this with an argument that that distributional worries themselves might impact the failure to properly adjust and hence provoke a crisis. Our analysis included a brief overview of those distributional trends and social policy responses that have evolved before and after major currency/financial crises in Mexico and Argentina. From the literature on this subject, we noted that financial crises can be counted on to negatively impact the poor and the distribution of income, generally through real sector and fiscal channels. Both of the countries examined in this paper seem to bear this out, although it is important to note that the asset losses of higher-income groups, at least in Mexico, runs against any simple distributional dichotomy of rich and poor. At the same time, and upon closer examination of the financial crises suffered by Mexico and Argentina, there is reason to believe that pre-existing patterns of regressive income distribution, as well as concerns to avoid exacerbating social stress, may also play some role in triggering such crises.

In particular, the difficulties in each case of coordinating market reforms with an unexpectedly long adjustment lag at the level of incomes and wages prompted policy makers to

sacrifice exchange rate competitiveness and fiscal probity for the sake of social peace. Once the external indicators had deteriorated to the point where a currency adjustment was inevitable, political standoffs in each case produced policy paralysis as domestic stakeholders scrambled to avoid the costs of adjustment. While latent distributional tensions had been papered over with an over-reliance on pegged exchange rates, loose fiscal strategies, and politically motivated ”safety net” spending, the maintenance of this charade required massive borrowing from abroad. When this war of attrition finally gave way to hefty devaluations, the immediate outflow of capital in the era of securitized capital flows was such that draconian austerity programs were the only recourse. In the end, the burden of adjustment fell disproportionately on those very groups that politicians had sought to appease.

Thus, while we understand that many factors play into financial crisis, at least one lesson to be gleaned from this history is that the risk of macroeconomic crises could be mitigated by the implementation of targeted distributional strategies that alleviate the need to manipulate domestic purchasing power to offset the social stress of market reforms. Paying attention to distribution, then, is important even for those who have no particular concern for the poor *per se*. Otherwise, as Roland Bénabou (1996) has argued, the absence of credible equality-promoting measures creates the potential for a “steady-state” of mutually reinforcing high inequality and low distribution---the very condition in which Argentina now finds itself.

Moreover, our comparative analysis also suggests that the process of sinking in to this bleak steady-state, as well as the extent to which distribution worsens in the *wake* of a financial crisis, is policy induced. While it may be quite difficult for a given government to raise wages or protect broad categories of social spending in the throes of a financial meltdown, the post-crisis Mexican experience points to a range of more modest measures that can be pursued.[51] Despite continuing debates over the precise mix of policies to apply in ameliorating the distributional hit from a financial crisis, there is now widespread agreement within the policy community that Latin American governments are well-advised to: 1) cushion the blows to the poor to the fullest extent within the fiscal parameters of the shorter-term stabilization program; and 2) work to develop a long-run strategy that targets human capital investments in ways that will eventually arm the poor with the higher-level skills now demanded by a market-based economy. At the

[51] These include the design of temporary safety net strategies that offer some combination of employment relief, social programming to meet basic needs, and the provision of micro-finance (Graham 1994; Mahoney 2001).

very least, these are necessary first steps for tackling the distributional gridlock that continues to test domestic political stability in post-crisis Argentina.

Yet, in spite of valiant efforts in the political economy literature to pinpoint the conditions under which such short- and longer-term strategies are most likely to come to fruition (Niles 2001), our cases still defy neat packaging. In Mexico, the thin but symbolic PRONASOL safety-net strategy had been in place since 1988 as the PRI's main response to the crumbling of the old state-financed corporatist pillars that once held the electorate so closely to the ruling party. This preexisting effort, albeit flawed and politically driven, established a precedent of sorts for the launching of a more targeted social investment program in the period following the 1994 crisis. But the incoming Zedillo administration also enjoyed a full discrediting of the approaches of the previous administration and thus took advantage of the opening to try new strategies in poverty alleviation as well as in other areas. It was in this atmosphere of crisis and flux that policy entrepreneurs were able to maneuver, extracting Mexican social policy from its traditional institutional home in the Ministry of Social Development and locating it in the Ministry of Finance. There, distributional reform was treated as a serious budget exercise---one that resulted in streamlined targeting, pilot programs, and professional external program evaluation (IFPRI 2000; 2001a; 2001b). The result, PROGRESA, has been a program that is the antithesis of Salinas's PRONASOL strategy.

It is tempting to attribute Mexico's measured distributional inroads post-1995 to the presence of truly internationalized policy makers in the federal bureaucracy and to the serious effort invested in program design. Careful studies do show that the highly targeted approach of PROGRESA seems to be largely on track and robust to various measures of poverty (Skoufias and de la Vega 2001; Wodon et al 2003), a fact which has inspired other Latin American countries to try and replicate the program. It is also clear that that the Mexican experience owes much to a small group of "iconoclastic" reform-mongers who took responsibility to: reposition social policy in the more neutral and efficiency-minded finance ministry; disentangle social policy from the tight tentacles of party politics, especially the PRI; and to generalize targeted distributional efforts to urban populations, after concentrating for more than a decade on rural groups where the relationship between the PRI patronage machine and vote-buying image of any social program is still difficult to dispel. In short, this end-run through the bureaucracy partly reflected the efforts of select policy entrepreneurs (Levy 2001), who began to see distributional

redress less as a political pay-off and more as an investment in growth – and began redesigning policy with this goal in mind. In essence, Mexican social policy has become authentically "second generation," opposed to the "second tier" and short-term compensatory status that it had been assigned through 1995.

Yet the Mexican experience also raises concerns about process: many might be offended by PROGRESA's bunker-like origins and the overall tone runs against the burgeoning of democracy and civil society in contemporary Mexico. On the other hand, dire poverty can also be offensive, and the program has indisputably made inroads in rectifying this problem in Mexico. In terms of future research on the Mexican case, it would be important to explore the extent to which a program such as PROGRESA has succeeded in garnering *ex-post* pro-poor distributional coalitions that can sustain demand for the kinds of targeted human capital investments that have made for the program's early success; the generation of such reform constituencies will obviously be key to preserving the integrity of neutral targeting and maintaining policy momentum, as Rodrik (1991), Bénabou (1996) and others have argued.

What is striking is the fact that Mexico was eventually able to rise to the occasion on this policy front, resuscitating its economy and tackling distribution and poverty in a way than seems well beyond Argentina's reach at this point in time. Certainly, the external variables confronting Argentina are different. Mexican growth had recovered by 1996, and the effective use of multilateral assistance was essential to this task. Although recovery is slowly underway in Argentina, the sustainability of GDP gains is overshadowed by the country's enormous debt default and the halting progress that has been made in repairing this financial damage, especially on the international front. However, this break with international creditors has also been accompanied by a willingness of domestic business to consider measures that will raise wages and perhaps taxes.

In any case, "second generation" reforms like innovative social policy may seem a bit distant given that the 1999-2002 deterioration of earlier reform advances has catapulted Argentina back to square one of the first generation reform agenda. Although the multilaterals have been far more committed to supporting distributive strategies than they were in earlier eras, Argentina has yet to fully resolve its default status with those institutions.[52] Moreover, the

[52] Héctor Tobar, "Argentina, IMF Make Deal to Ease Nation's Debt Crisis," *New York Times*, September 11, 2003, p. A8.

multilateral influence is not necessarily positive, since both multilateral officials and local supporter of market principles concerned that interventions could derail the larger project of liberalization, particularly in light of the Kirchner administration's less market-friendly policy discourse. The worry, as Kanbur 2001: 1092) puts it: "Given them an inch of nuance and they'll take a mile of protection."

The real curiosity is why Argentina did not make a more innovative shift in social policy when afforded the breathing space in the aftermath of the tequila shock. A few years later, distributional amelioration and institutional reform geared toward more efficient investment in human capital and delivery of public goods was exactly the platform on which de la Rua's coalition had been elected. Yet, the window of opportunity for creative reform gestures had basically closed by 1999, and thus little progress was made. Instead, all sides resisted any policy shift whatsoever with disturbing tenacity, which rendered Argentina's social policy framework the same overlapping patchwork of poorly targeted programs that spanned the urban and rural areas.

Part of the solution to Argentina's current dilemma will involve articulating a development model beyond short-term stabilization. The dust is still settling on just how competitive the Argentine economy has become since the implementation of market reforms in the 1990s, as the impacts of exchange rate overvaluation can repress the potential dynamism from economic restructuring. In contrast to Mexico, where policy makers clearly articulated a trade-led development strategy, Argentine leaders simply pointed to rapid increases in measured productivity through the 1990s as evidence of modernization, failing to note how much these were driven by simple down-sizing. Meanwhile, the implicit model seemed to be based on a vision of becoming the financial center for the Americas, replete with white-collar work and higher returns to education.

With the financial sector in chaos, the real sector now matters more. Argentina is showing some early signs of an export recovery led by agriculture. With the peso running at about 34 cents on the U.S. dollar, the devaluation wiped out most farmers' debts by effectively tripling the domestic value of their export sales. Thus, about half of the country's US$15 billion in hard currency earnings in 2002 can be attributed to an agricultural sector that is now described as "hyper-efficient."[53] But this will not yield a real improvement for the urban poor unless some

[53] Tony Smith, "Farm Exports Boom in Argentina," *New York Times*, March 26, 2003, p. W1.

new industrial strength can be generated. In short, an explicit pro-poor strategy is needed to reverse the rising tide of inequality that we have documented here.

A new political framework is also needed. The problem is that there may be no "natural" coalition for the micro-level progressive reform policies required in Argentina, partly because the rewards tend to be longer-term and much less tangible than the growth and stabilization gains that readily united all Argentines around the macroeconomic strategy of the 1990s. In Mexico, a second-generation social policy only emerged after the full discrediting of Salinas-era safety-nets, and the quest of the more results-oriented Zedillo team to finally penetrate the country's deeply entrenched patterns of poverty and inequality. Even then, the "coalition" was initially just a handful of renegade technocrats willing to rise above the PRI's traditional wing and its empty promises of future prosperity.[54] Policy success can nurture subsequent coalitions, of course, and this will be key for Argentina in the future.

To be sure, Argentina has made some progress: targeted social spending has risen as a share of total social spending and the Plan de Jefas y Jefes de Hogares Desocupados is providing part-time employment even if it is doing little to alleviate poverty. Moreover, since assuming power in May 2003, President Néstor Kirchner has openly called for a more active social policy, and the shift in government rhetoric toward "productive activities" has been accompanied by the development of a subcomponent of the Plan, "Manos a la obra" which is supposed to promote micro-enterprises.[55]

However, it is hard to know how well-thought out or feasible any alternative might be, particularly since the President has spent much of his international political capital playing a game of chicken with the IMF. Kirchner's domestic profile is on the rise, partly because of standing up to the IMF and partly because of dramatic and well-received judicial reforms. Even then, the politics are more reminiscent of Argentina's chaotic and stalemated past, with Kirchner supporting a majoral candidate for Buenos Aires against his own party and scrambling to form a coalition not solely reliant of traditional Peronist forces. However, this will leaves the Peronists, experts at frustrating reform, in the role of backbiter, crucially needed changes in economic policy have been slow in coming, and Kirchner has made some expensive promises with regard to teacher salaries, pension support, and public works programs. With all these cross-cutting

---

[54] Authors' 3/20/03 interview with Miguel Székely, Under-Secretary of Social Development, Ministry of Social Development (SEDESOL), Mexico City. Also see Levy (2001).

[55] We thank Ariel Fiszbein of the World Bank for pointing this out to us.

pressures, there may be even less room for a group of committed and concerned social policy entrepreneurs to maneuver in the *rincones* of the public infrastructure as happened in the Zedillo administration.

In terms of future research and policy directions, it may also be important to highlight one important pitfall of the Mexican model which will limit both its applicability and its desirability. We have noted that PRONASOL was locally-controlled, demand-driven, and group-determined; PROGRESA, by contrast, has been federally-directed, supply-focused, and individualistic. It is precisely this combination of central command and individual targeting that has been celebrated in the literature. PROGRESA has essentially focused on just the human capital side of the positive equity-growth correlation.

While this individualistic model may be in touch with market principles, it may not be as effective in the longer-haul, particularly in terms of constructing the broader social fabric necessary to achieve sustainable policy. Brinkerhopf and Goldsmith (2003), for example, suggest a unique way to overcome the "war of attrition" so central to currency crashes: improve public participation in macroeconomic decision-making. The basic logic is that this will secure "ownership" of the policy package, and it is more likely to benefit poorer citizens and hence avoid destructive distributional conflicts. In the same vein, incorporation of citizen preferences and voice may be necessary for generating the political coalition to sustain efficient social policy into the future.

This may run against the iconoclastic experience in Mexico where the temporary shielding of social policy from political pressure allowed a creative experiment to take root. As suggested above, a technocratic approach in Argentina may also be appealing in light of the destructive impact that political turmoil has had on that country. However, we may be facing a false choice if we consider only the polar options of the individualistic and centralized strategies typical of PROGRESA or the rough-and-tumble jockeying for social assistance now characteristic of Argentina. While Mexico's results in combating poverty are certainly more persuasive, neither case is particularly conducive to the creation of cohesive reform coalitions. A more viable social policy could and should bring together the various stakeholders around a reform agenda that simultaneously incorporates the principles of democratic accountability, economic efficiency, and distributional equity.

Bibliography

Alarcon, Diana.2003. "Income Distribution and Poverty Alleviation in Mexico: A Comparative Analysis." In Kevin J. Middlebrook and Eduardo Zepeda, editors, *Confronting Development: Assessing Mexico's Economic and Social Policy Challenges.* Stanford, CA: Stanford University Press.

Alesina, Alberto and Allan Drazen. 1991. "Why are Stabilizations Delayed?" *American Economic Review,* vol. 81, no. 5: 1170-1188.

Alston, Lee J. and Andrés Gallo. 2002. "The Political Economy of Bank Reform in Argentina Under Convertibility." *Policy Reform*, vol. 5, no. 1: 1-16.

Altimir, Oscar, and Luis Beccaria. NO DATE. *Efectos de los cambios macroeconómicos y de las reformas sobre la pobreza urbana en la Argentina*. Buenos Aires: Universidad Nacional de General Sarmiento, Instituto de Ciencias.

Beccara, Luis, and Ricardo Carciofi. 1995. "Argentina: Social Policy and Adjustment during the 1980s." In Nora Lustig, editor, *Coping with Austerity: Poverty and Inequality in Latin America.* Washington, DC: Brookings Institution.

Behrman, Jere, Nancy Birdsall, and Miguel Székely. 2000. "Economic Reform and Wage Differentials in Latin America." Working Paper 435. Washington, DC: Inter-American Development Bank.

Benanou, Roland. 1996. "Unequal Societies." Cambridge, MA: National Bureau of Economic Research. Working Paper 5583.

Benton, Allyson Lucinda. 2003. "The Provincial Origins of National Economic Instability in Argentina." Paper presented at the XXIV Congress of the Latin American Studies Association, Dallas, Texas. March 27-29, 2003.

Birdsall, Nancy. 1999. "Generating Opportunities in Unequal Societies." WDR on Poverty and Development 2000/01. Washington D.C.: Stiglitz Summer Research Workshop on Poverty.

Birdsall, Nancy and Juan Luís Londoño. 1997. "Asset Inequality Matters: An Assessment of the World Bank's Approach to Poverty Reduction." *American Economic Review*, vol. 87, no. 2 (AEA Papers and Proceedings): 32-37.

Boylan, Delia. 2002. *Defusing Democracy: Central Bank Autonomy and the Transition from Authoritarian Rule*. Ann Arbor, MI: University of Michigan Press.

Brinkerhoff, Derick W. and Arthur A. Goldsmith. 2003. "How Citizens Participate in Macroeconomic Policy: International Experience and Implications for Poverty Reduction." *World Development* forthcoming.

Bulmer-Thomas, Victor. 1994. *The Economic History of Latin America since Independence.* Cambridge: Cambridge University Press.

Cardoso, Eliana. 2000. "Brazil's Currency Crisis: The Shift from an Exchange Rate Anchor to a Flexible Regime." In Carol Wise and Riordan Roett, editors, *Exchange Rate Politics in Latin America.* Washington, D.C.: Brookings Institution Press, 2000, pp. 70-92.

Corden, W. Max. 2000. "Exchange Rate Regimes and Policies: An Overview." In Carol Wise and Riordan Roett, editors, *Exchange Rate Politics in Latin America*. Washington, D.C.: Brookings Institution Press, 2000, pp. 23-42.

Cornia, Andrea Giovanni, and Sanjay Reddy. 2001. "The Impact of Adjustment-related Social Funds on Income Distribution and Poverty." World Institute for Development Economics Research (WIDER), United Nations University, Discussion Paper No. 2001/1 (May).

Corrales, Javier. 2002. *Presidents without Parties: The Politics of Economic Reform in Argentina and Venezuela in the 1990s.* University Park, PA: Pennsylvania State University Press.

Cortez, Willy W. 2001. "What is Behind Increasing Wage Inequality in Mexico?" *World Development,* vol. 29, no. 11: 1905-1922.

Craig, Ann and Wayne Cornelius. 1995. "Houses Divided: Parties and Political Reform in Mexico." In Scott Mainwaring and Timothy Scully, editors, *Building Democratic Institutions*. Stanford, CA: Stanford University Press, pp. 249-297.

Damill, Mario, Roberto Frenkel, and Roxana Maurizio. 2002. "Argentina: A Decade of Currency Board -- An Analysis of Growth, Employment, and Income Distribution." Geneva: International Labor Office.

Davis, Benjamin, Sudhanshu Handa, and Humberto Soto. 2003. "Households, Poverty and Policy in Times of Crisis: Mexico, 1992-96. Mimeo, Food and Agriculture Organization.

Díaz-Bonilla, Eugenio and Hector Schamis. 2001. "From Redistribution to Stability: The Evolution of Exchange Rate Policies in Argentina, 1950-98." In Jeffry Frieden and Ernesto Stein, editors, *The Currency Game: Exchange Rate Politics in Latin America.* Washington, DC: Inter-American Development Bank, pp. 65-118.

Dornbusch, Rodiger and Alejandro Werner. 1994. "Mexico: Stabilization, Reform, and No Growth." *Brookings Papers on Economic Activity*, no. 1: 253-315.

Edwards, Sebastian, and Roberto Rigobon. 2002. "Currency Crisis and Contagion: An Introduction." *Journal of Development Economics,* vol. 69, no.2: 307-313.

Estache, Antonio, Andres Gomes-Lobo, and Danny Leipziger. 2001. "Utilities Privatization and the Poor: Lessons and Evidence from Latin America." *World Development,* vol. 29, no. 7:1179-1198.

Faucher, Philippe and Leslie Elliot Armijo. 2003. "Currency Crises and Decisionmaking Frameworks: The Politics of Bouncing Back in Argentina and Brazil." Paper presented at the XXIV Congress of the Latin American Studies Association, Dallas, Texas, March 27-29, 2003.

Forteza, Alvaro, and Martin Rama. 2000. "Labor Market 'Rigidity' and the Success of Economic Reforms Across more than One Hundred Countries." Paper prepared for a research project on The Impact of Labor Market Policies and Institutions on Economic Performance, World Bank's Research Committee.

Frankel, Roberto. 2002. "Argentina: A Decade of the Convertibility Regime." *Challenge*, vol. 45, no. 4: 41-59.

Frieden, Jeffry. 1997. "The Politics of Exchange Rates." In Sebastian Edwards and Moisés Naím, editors, *Anatomy of an Emerging-Market Crash: Mexico 1994.* Washington, DC: Carnegie Endowment for International Peace, pp. 81-94.

Frieden, Jeffry, Piero Ghezzi, and Ernesto Stein. 2001. "Politics and Exchange Rates: A Cross-Country Approach." In Jeffry Frieden and Ernesto Stein, editors, *The Currency Game: Exchange Rate Politics in Latin America*, Washington, DC: Inter-American Development Bank.

Frieden, Jeffry, and Ernesto Stein. 2001. "The Political Economy of Exchange Rate Policy in Latin America: An Analytical Overview." In Jeffry Frieden and Ernesto Stein, editors, *The Currency Game: Exchange Rate Politics in Latin America*. Washington, DC: Inter-American Development Bank.

Galiani, Sebastián and Pablo Sanguinetti. 2000. "Wage inequality and trade liberalization: Evidence from Argentina." Buenos Aires: Universidad Torcuato Di Tella, mimeo.

Galiani, Sebastián, Daniel Heymann and Mariano Tommasi. 2002. "Missed Expectations: The Argentine Convertibility." Mimeo.

Gasparini, Leonardo C. 1999. "Desigualdad en la distribución del ingreso y bienstar – estimaciones para la Argentina." Fundación de Investigaciones Económicas Latinoamericanas (FIEL), editor, *La distribución del ingreso en la Argentina,* edited by. Buenos Aires: FIEL, pp. 35-83.

---------. 1999b. “Incidencia distributiva del gasto público social y de la política tributaria en la Argentina.” In Fundación de Investigaciones Económicas Latinoamericanas (FIEL), editors, *La distribución del ingreso en la Argentina*. Buenos Aires: FIEL, pp. 347-370.

---------. 1999c. “Un análisis de la distribución del ingreso en la Argentina sobre la base de descomposiciones.” In Fundación de Investigaciones Económicas Latinoamericanas (FIEL), editors, *La distribución del ingreso en la Argentina.* Buenos Aires: FIEL, pp. 87-91.

Gelbach, Jonath, and Lant H. Pritchett. 1997. “More for the Poor is Less for the Poor: The Politics of Targeting.” World Bank Policy Research Working Paper. Washington, DC: World Bank.

Gereffi, Gary. 2003. “Mexico’s Industrial Development: Climbing Ahead or Falling Behind in the World Economy?” In Kevin J. Middlebrook, and Eduardo Zepeda, editors, *Confronting Development: Assessing Mexico’s Economic and Social Policy Challenges.* Stanford, CA: Stanford University Press.

Garman, Christopher, Stephan Haggard, and Eliza Willis. 2001. “Fiscal Decentralization: A Political Theory with Latin American Cases.” *World Politics*, vol. 53, no. 1: 205-236.

Gil-Díaz, Francisco and Agustín Carstens. 1997. “Pride and Prejudice: The Economics Profession and Mexico’s Financial Crisis.” In Sebastian Edwards and Moisés Naím, editors, *Anatomy of an Emerging-Market Crash: Mexico 1994,* Washington, DC: Carnegie Endowment for International Peace, pp. 165-200.

Gourevitch, Peter. 1986. *Politics in Hard Times*. Ithaca, NY: Cornell University Press.

Haggard, Stephan, and Robert Kaufman. 1989. “The Politics of Stabilization and Structural Adjustment.” In Jeffrey Sachs, editor, *Debt and Economic Performance: Selected Issues,*. Chicago: University of Chicago Press.

----------. 1995. *The Political Economy of Democratic Transitions*. Princeton, NJ: Princeton University Press.

Hale, David. 1997. “The Markets and Mexico: The Supply-Side Story.” In Sebastian Edwards and Moisés Naím, editors, *Anatomy of an Emerging-Market Crash: Mexico 1994,* Washington, DC: Carnegie Endowment for International Peace, pp. 201-245.

Hanson, Gordon. 2003. “What has Happened to Wages in Mexico since NAFTA?” Cambridge, MA: National Bureau of Economic Research. Working Paper 9563.

Hausmann, Ricardo, and Andrés Velasco. 2002. “Hard Money’s Soft Underbelly: Understanding the Argentine Crisis.” Paper prepared for the Brookings Trade Forum. Kennedy School of Government, Harvard University.

He, Li. 2000. "Political Economy of Income Distribution: A Comparative Study of Taiwan and Mexico." *Policy Studies Journal*, vol. 28, no. 2.

Inter-American Dialogue Policy Report. 2003. "The Troubled Americas." Sol M. Linowitz Forum. Washington DC.

International Food Policy Research Institute (IFPRI). 2000. "Is PROGRESA Working? Summary of the Results of an Evaluation by IFPRI." Washington, DC: IFPRI.

----------. *IFPRI Perspectives*. 2001a. "PROGRESA Breaks the Cycle of Rural Poverty." vol. 23.

----------. *IFPRI Perspectives*. 2001b. "Macroeconomic Shocks Effect Poverty, Income Distribution." vol. 23.

International Finance Corporation. 2001. *Trends in Private Investment in Developing Countries: Statistics for 1970-2000*, a database downloadable at www.ifc.org/economics/data/dataset.htm.

Kanbur, Ravi. 2001. "Economic Policy, Distribution and Poverty: The Nature of Disagreements." *World Development,* vol. 29, no. 6: 1083-1094.

Kessler, Timothy. 2000. "The Mexican Peso Crash: Causes, Consequences, Comeback." In Carol Wise and Riordan Roett, editors, *Exchange Rate Politics in Latin America,* Washington, DC: Brookings Institution Press, 2000, pp. 43–69.

La Porta, Rafael, Florencio López-de-Silanes, and Guillermo Zamarripa. 2002. "Related Lending." Cambridge, MA: National Bureau of Economic Research. Working Paper 8848.

Levison, Deborah, Karine S. Moe, and Felicia Marie Knaul. 2001. "Youth Education and Work in Mexico." *World Development,* vol. 29, no. 1: 167-188.

Levy, Santiago. 2001. "Reorienting Mexico's Social Policy." In Andrew. D. Selee, editor, *Mexico in Transition*. Washington, DC: Woodrow Wilson Center Reports on the Americas, no. 1, pp. 27-34.

Lopez-Acevedo, Gladys, and Angel Salinas. 2000. "How Mexico's Financial Crisis Affected Income Distribution." Working Paper no. 2406. Prepared for the "Earnings Inequality after Mexico's Economic and Educational Reforms" project of the World Bank. Washington, DC: World Bank, see http://econ.worldbank.org/docs/1161.pdf.

Lozano, Claudio, and Eduardo Manjovsky. 2001. *La economia argentina: lLuego de la dictadura*. Buenos Aires: Instituto de Estudios y Formacion.

Lustig, Nora. 1998. *Mexico: The Remaking of an Economy.* Washington, DC: Brookings Institution, second edition.

----------. 1995. Editor, *Coping with Austerity: Poverty and Inequality in Latin America.* Washington, DC: Brookings Institution.

Mahoney, William F. 2001. “Evaluating Emergency Programs.” Mimeo. Washington, DC: World Bank.

McQuerry, Elizabeth. 1999. “The Banking Sector Rescue in Mexico.” *Economic Review*, Federal Reserve Bank of Atlanta, Third Quarter.

Mora y Araujo, Manuel. 2002. *La estructura social de la Argentina: Evidencias y conjecturas acerca de la estratificación actua*. Santiago, Chile: División de Desarrollo Social, Projecto CEPAL/GTZ Sobre “Desarrollo social y equidad en América Latina y el Caribe.”

Mussa, Michael. 2002. *Argentina and the Fund: From Triumph to Tragedy.* Washington, DC: Institute for International Economics.

Nafziger, E. Wayne and Juha Auvinen. 2000. “The Economic Causes of Humanitarian Emergencies.” In E. Wayne Nafziger, Frances Stewart, and Raimo Väyrynen, editors, *War, Hunger, and Displacement,* Oxford: Oxford University Press, vol. 1.

Niles, Kimberly. 2001. “Economic Adjustment and Targeted Social Spending: The Role of Political Institutions.” Paper prepared for the World Development Report 2001 meetings, Castle Donington, United Kingdom.

O’Keefe, Thomas. 2003 “A Resurgent MERCOSUR: Confronting Economic Crises and Negotiating Trade Agreements.” *Agenda Papers* no. 60, North-South Center, University of Miami.

Pastor, Manuel Jr. 1994. "Mexican Trade Liberalization and NAFTA." *Latin American Research Review,* vol. 29, no. 3: 153-173.

----------1998. “Pesos, Policies, and Predictions: Why the Crisis? Why the Surprise? Why the Recovery?” In Carol Wise, editor, *The Post-Nafta Political Economy: Mexico and the Western Hemisphere,*. University Park: Pennsylvania State University Press, pp. 119-147.

Pastor, Manuel and Carol Wise. 1994. "The Origins and Sustainability of Mexico's Free Trade Policy." *International Organization*, vol. 48, no. 3: 459-489.

----------1997. "State Policy, Distribution, and Neoliberal Reform in Mexico." *Journal of Latin American Studies,* vol. 29, no. 2: 419-456.

----------1999. “Stabilization and Its Discontents: Argentina's Economic Restructuring in the 1990s.” *World Development*, vol. 27, no. 3, May 1999: 477-503.

----------2001. “Argentina’s Dilemma: From Poster Child to Basket Case.” *Foreign Affairs*, vol 80, no. 6: 60-72.

----------2003a. “A Long View on Mexico’s Political Economy: What’s Changed? What are the Challenges?” In Andrew Selee and Joseph Tulchin, editors, *Mexican Politics and Society in Transition*. Boulder: Lynne Rienner Press, pp. 179-213.

----------2003b. “No Longer at Ease: The Fox Administration and the Political Economy of Democratic Transition in Mexico.” mimeo, UC Santa Cruz and USC.

Perry, Guillermo and L. Serven. 2002. “The Anatomy of a Multiple Crisis: Why Was Argentina Special and What We Can Learn From It.” Mimeo. World Bank, May.

Portes, Alejandro, and Kelly Hoffman. 2003. “Latin American Class Structures: Their Composition and Change during the Neoliberal Era.” *Latin American Research Review,* vol. 38, no. 1: 41-82.

Rajan, Ramkishen and Iman Sugema. 2000. “Government bailouts and monetary disequilibrium: common fundamentals in the Mexican and East Asian currency crises.” *North American Journal of Economics and Finance* 11 (2000) 123–135

Ravallion, Martin. 1991. “Reaching the Rural Poor Through Public Employment: Arguments, Evidence, and Lessons from South Asia.” *World Bank Research Observer*, vol. 6, no. 2: 153-175.

----------.2001. “Growth, Inequality and Poverty: Looking Beyond Averages.” *World Development,* vol. 29, no. 11:1803-1815.

----------. 2002a. “Are the Poor Protected from Budget Cuts? Evidence for Argentina.” *Journal of Applied Economics,* vol. 5, no. 1: 95-121.

----------. 2002b. “An Automatic Safety Net?” *Finance and Development*, vol. 39, no 2 (June).

Rodrik, Dani. 1991. “Policy Uncertainty and Private Investment in Developing Countries.” *Journal of Development Economics*, vol. 36, no. 2: 229-242.

Sachs, Jeffrey, Aaron Tornell, and Andrés Velasco. (1995) “The Collapse of the Mexican Peso: What Have We Learned?” Cambridge, MA: National Bureau of Economic Research, Working Paper 5142.

Sadoulet, Elisabeth, Alain de Janvry and Bejamin Davis. 2001. “Cash Transfer Programs with Income Multipliers: PROCAMPO in Mexico.” *World Development,* vol. 29, no. 6:1043-1056.

Skoufias, Emmanuel. 2001. "PROGRESA and its Impacts on the Human Capital and Welfare of Households in Rural Mexico: A Synthesis of the Results of an Evaluation by IFPRI." International Food Policy Research Institute, Washington, DC, 2001

Skoufias, Emmanuel, Benjamin Davis and Sergio de la Vega. 2001. "Targeting the Poor in Mexico: An Evaluation of the Selection of Households into PROGRESA." *World Development,* vol. 29, no. 10: 1769-1784.

Starr, Pamela K. 2003. "Argentina: Anatomy of a Crisis Foretold." *Current History* February: 65-71.

Subbarao, Kalanidhi. 2003. "Systemic Shock and Social Protection: Role and Effectiveness of Public Works Programs." World Bank Social Safety Net Primer Series. Washington, DC: World Bank.

Tomassi, Mariano, Sebastian Saiegh, and Pablo Sanguinetti. 2001. "Fiscal Federalism in Argentina: Policies, Politics, and Institutional Reform." *Economia,* vol. 1, no. 2: 157-211.

Thorbecke, Erik and Chutatong Charumilind. 2002. "Economic Inequality and Its Socioeconomic Impact." *World Development,* vol. 30, no. 9: 1477-1495.

Whitehead, Laurence. 1998. "Mexico's 'Near Ungovernability' Revisited." Monica Serrano, editor, *Governing Mexico: Political Parties and Elections*. London: Institute of Latin American Studies, University of London, pp. 185-204.

Williamson, John. 1995. *What Role for Currency Boards?* Washington, D.C.: Institute for International Economics.

Wise, Carol. 2000. "Argentina's Currency Board: The Ties that Bind?" In Carol Wise and Riordan Roett, editors, *Exchange Rate Politics in Latin America*. Washington, DC: Brookings Institution, pp. 93-122.

----------2003a. *Reinventing the State*. Ann Arbor, MI: University of Michigan Press.

----------2003b. "Latin American Politics in the Era of Market Reform." In Carol Wise and Riordan Roett, editors, *Post-Stabilization Politics in Latin America.* Washington, DC: Brookings Institution, pp. 1-29.

Wodon, Quentin, et al. 2003. "The Impact of Public Transfers on Inequality and Social Welfare: Comparing Mexico's PROGRESA to other Government Programs." In World Bank, editor, *Mexico: Government Programs and Poverty.* Washington, DC: World Bank.

Wodon, Quentin and Mari Minowa. 2003. "Training for the Urban Unemployed: A Reevaluation of Mexico's Training Program, PROBECAT." In World Bank, editor, *Mexico: Government Programs and Poverty*. Washington, DC: World Bank.

World Bank. 2000. *Poor People in a Rich Country: A Poverty Report for Argentina.* Washington, DC: World Bank.

World Bank. 2003. *Mexico: Government Programs and Poverty. A Diagnostic for 2000.* Washington, DC: World Bank.

Distribution of Current Monetary Income by Household Deciles

Household Deciles *	1984	1989	1992	1994	1996	1998	2000	2002
	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile	Percent of Total Income to Household Decile
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
I	1.19	1.14	1.00	1.01	1.24	0.92	1.11	1.18
II	2.66	2.48	2.27	2.27	2.56	2.22	2.40	2.51
III	3.86	3.52	3.36	3.27	3.56	3.24	3.33	3.63
IV	5.01	4.56	4.38	4.26	4.60	4.33	4.32	4.67
V	6.26	5.76	5.45	5.35	5.67	5.47	5.47	5.87
VI	7.66	7.21	6.77	6.67	6.99	6.86	6.92	7.31
VII	9.68	9.02	8.62	8.43	8.78	8.76	8.65	9.15
VIII	12.42	11.42	11.22	11.19	11.38	11.59	11.29	11.83
IX	17.00	15.92	16.09	16.30	16.15	16.42	16.47	16.74
X	34.26	38.97	40.84	41.24	39.07	40.19	40.04	37.12
Gini Coefficient **	0.456	0.489	0.509	0.514	0.489	0.509	0.503	0.479

* Households are ordered in terms of income (the first decile includes the poorest, the last deciles the richest).

** The Gini coefficient is an aggregate measure of income inequality which ranges from zero in a completely equal society to one in a completely unequal society.

Source: INSTITUTO NACIONAL DE ESTADISTICA, GEOGRAFIA E INFORMATICA.
ENCUESTA NACIONAL DE INGRESOS Y GASTOS DE LOS HOGARES,
Third Quarter, 1984, 1989 Y 1992 (CD-ROM).
Third Quarter, 1994, 1996 Y 1998 (1998 CD-ROM).
Third Quarter, 2000, 2002 (www.inegi.gov.mx)

Table 1.

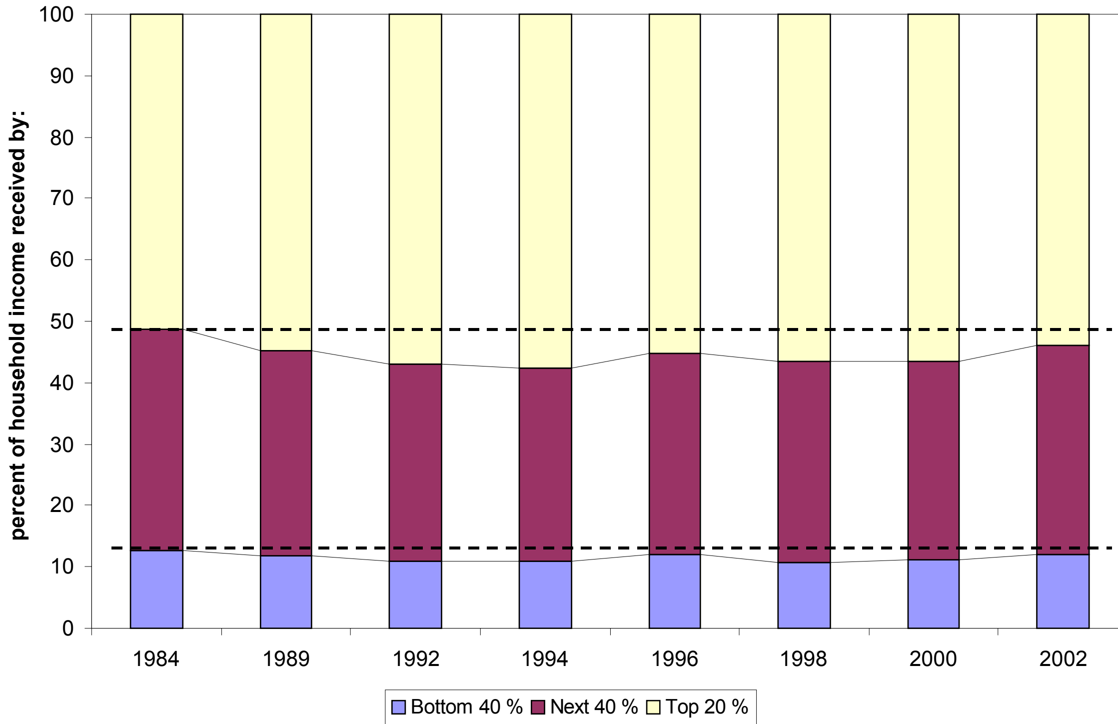

Figure 1.

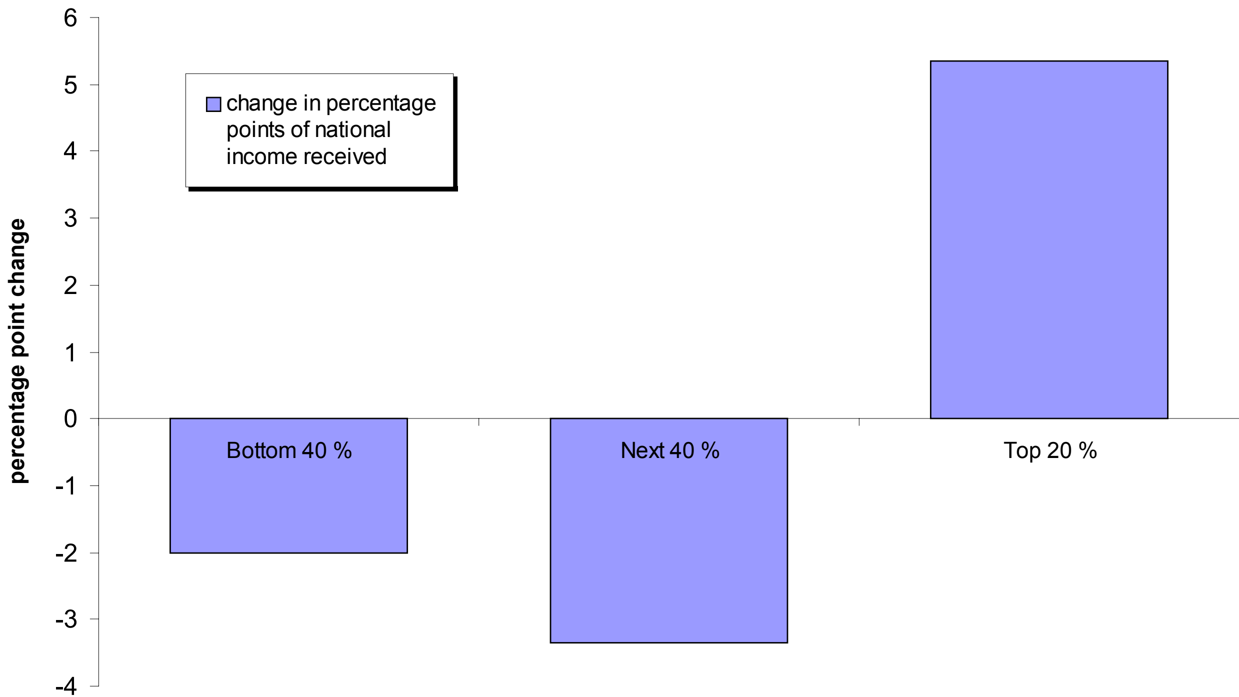

Figure 2.

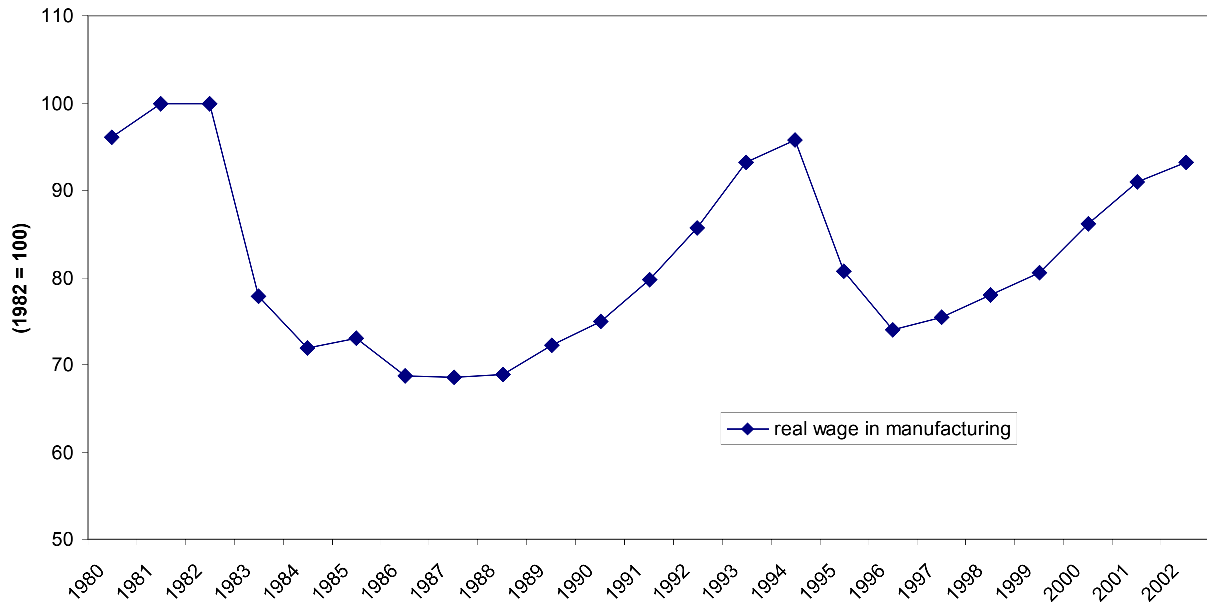

Figure 3.

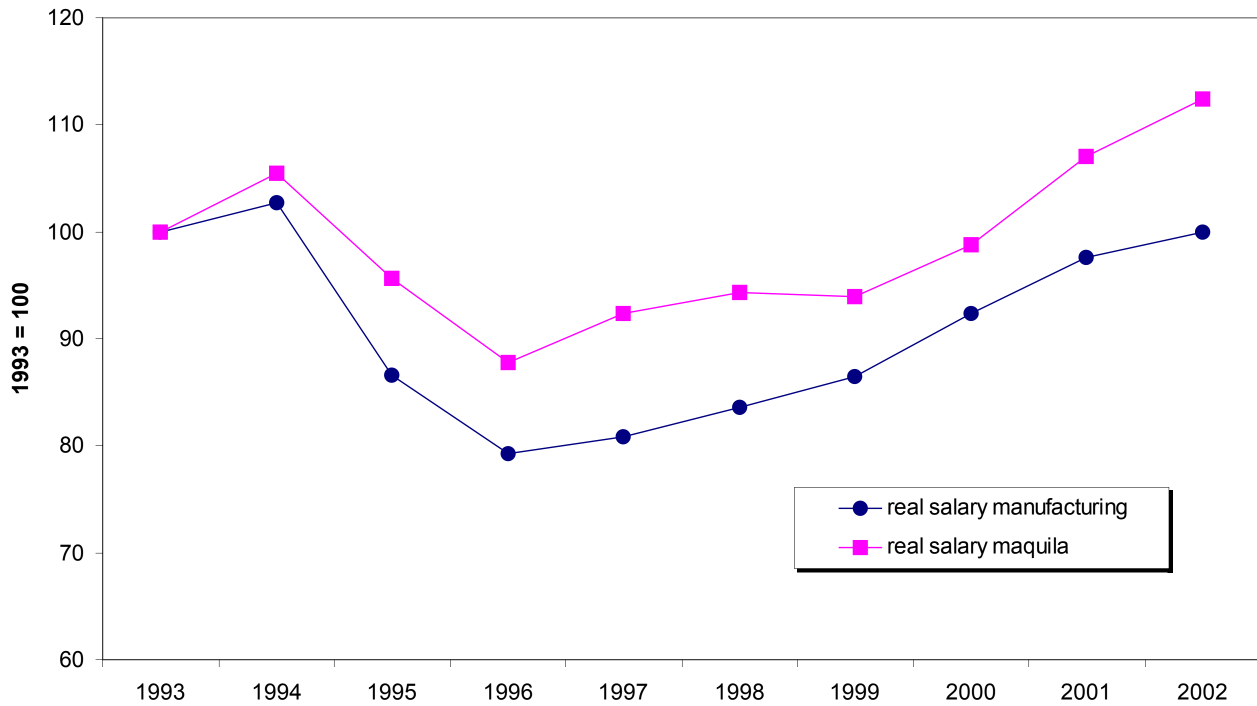

Figure 4.

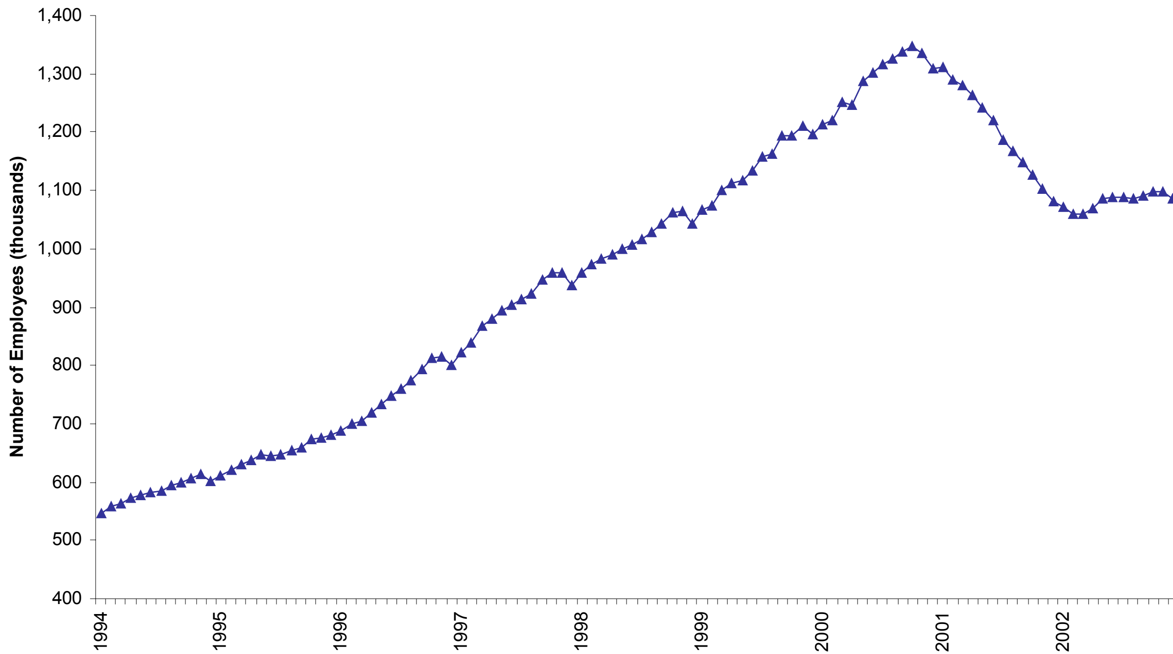

Figure 5.

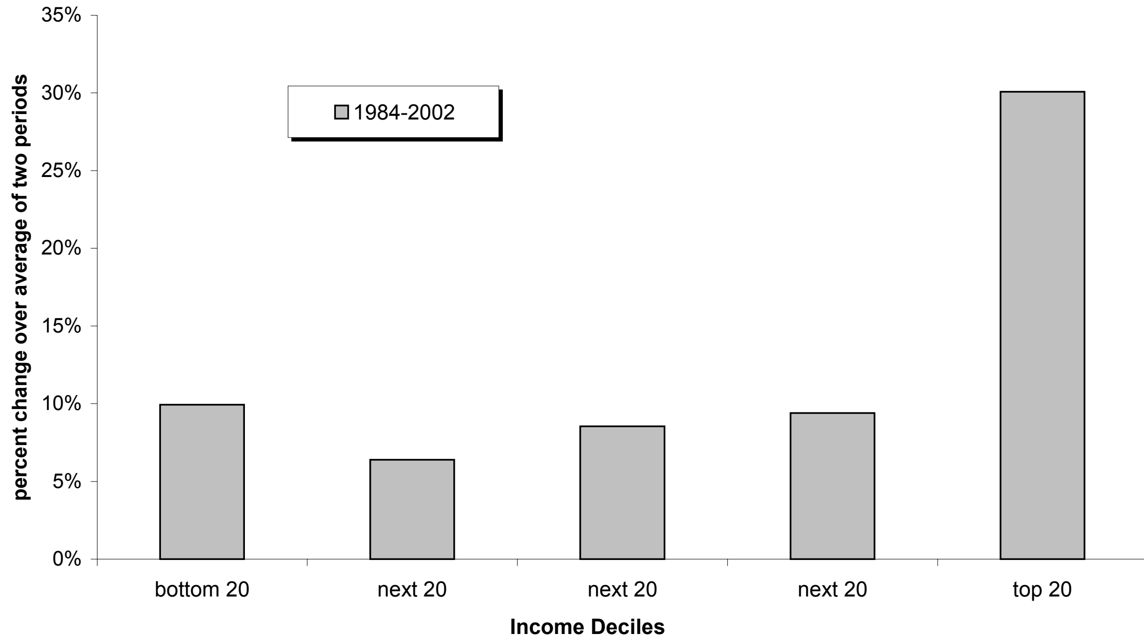

Figure 6.

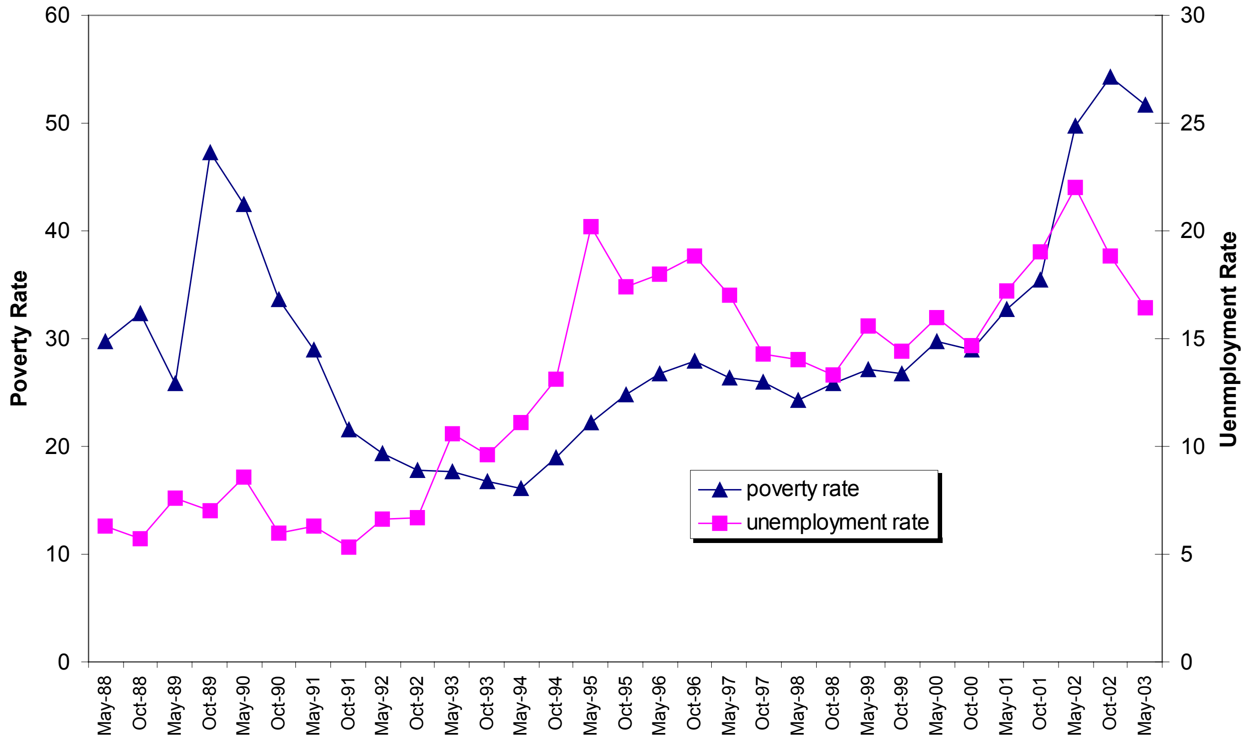

Figure 7.

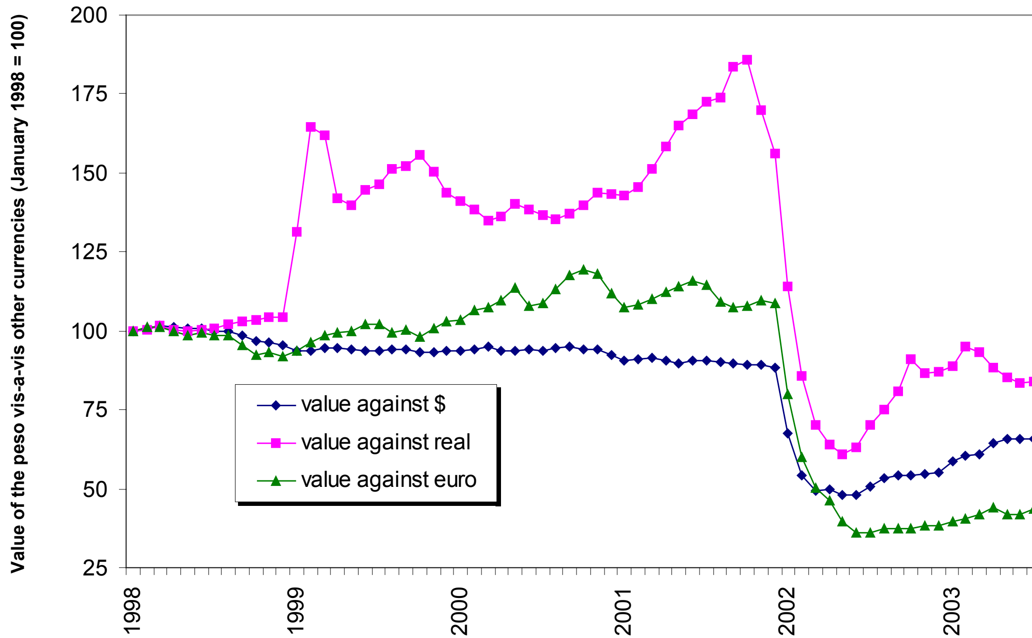

Figure 8.

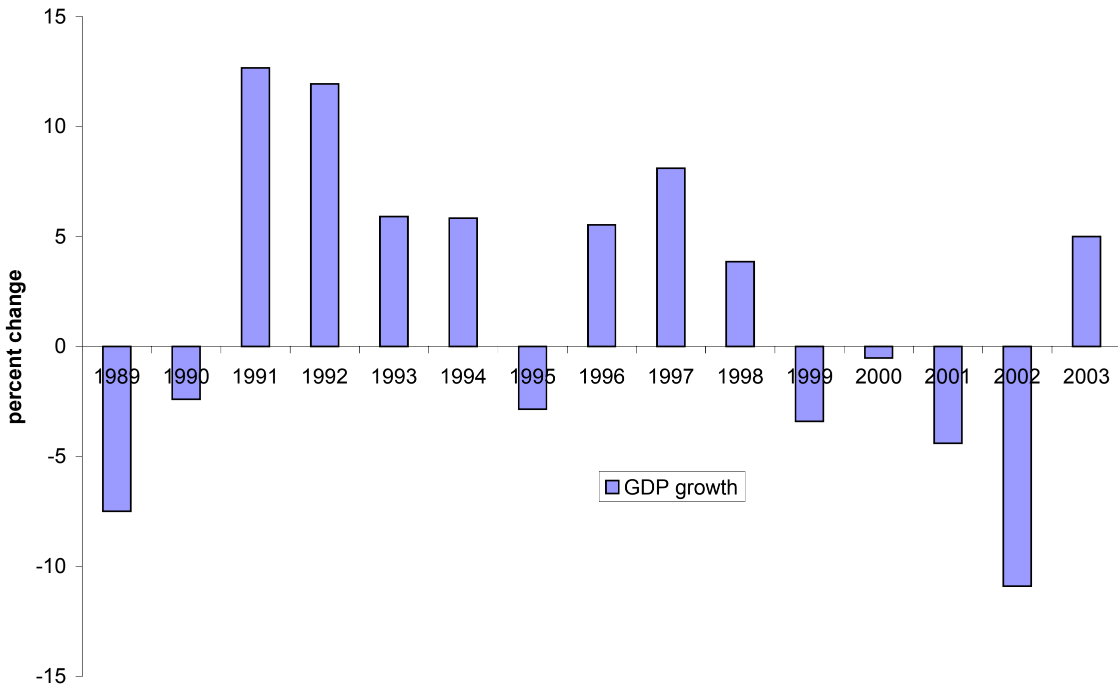

Figure 9

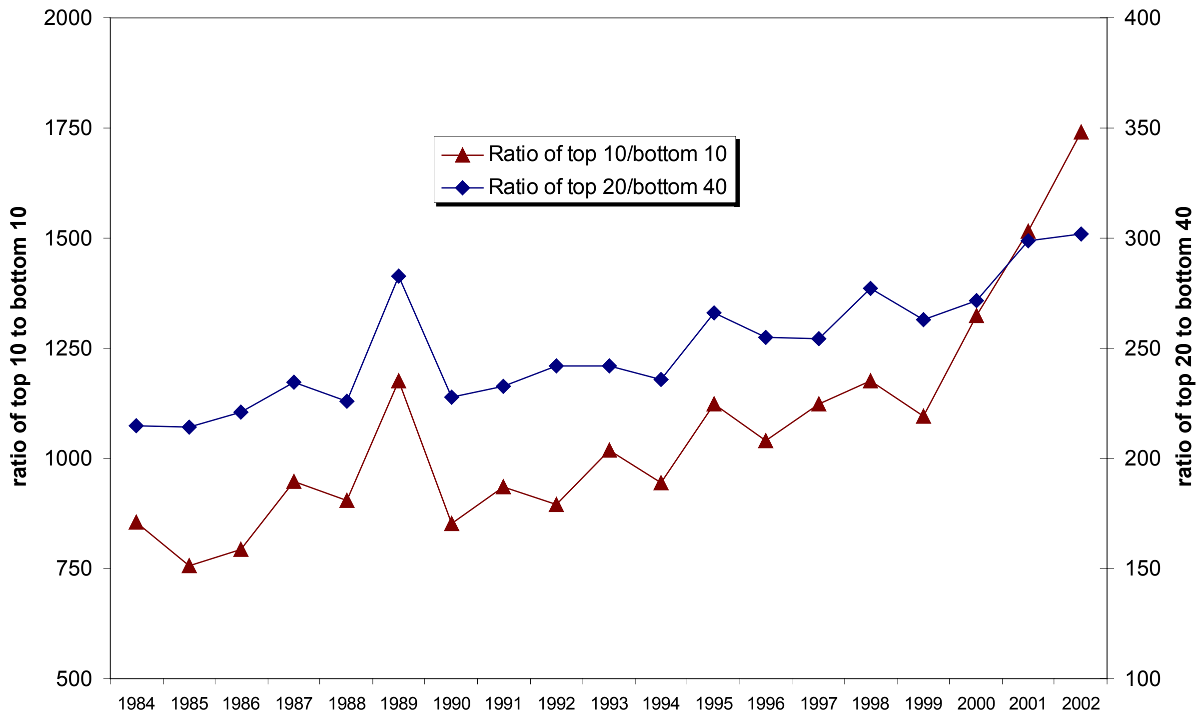

Figure 10

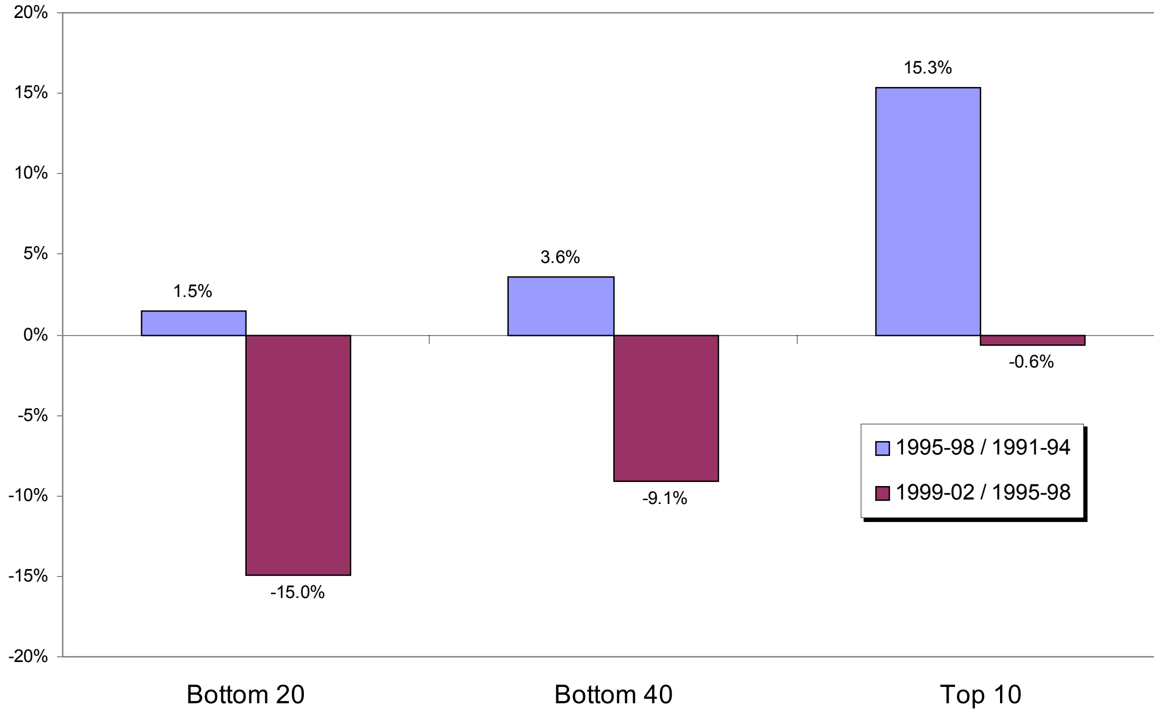

Figure 11

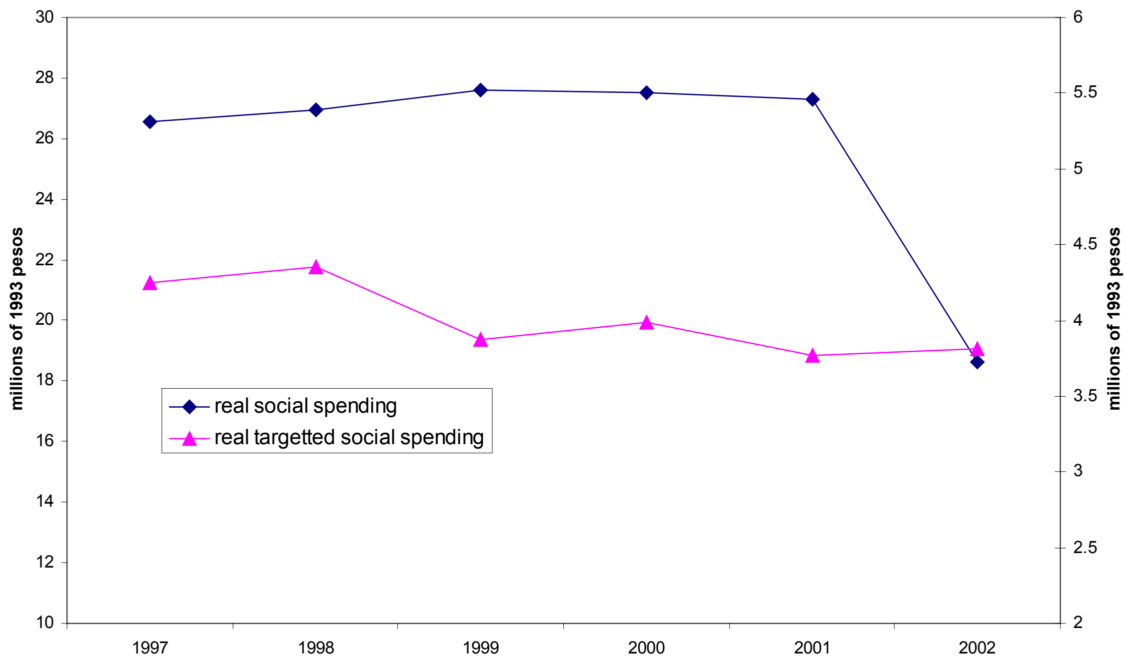

Figure 12

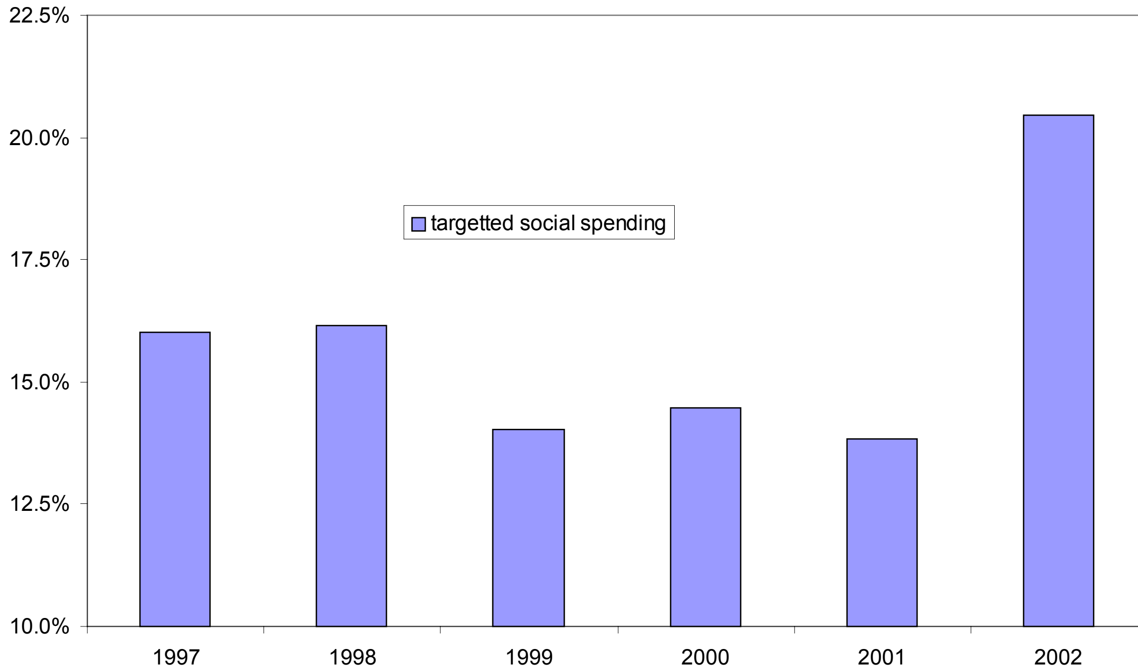

Figure 13

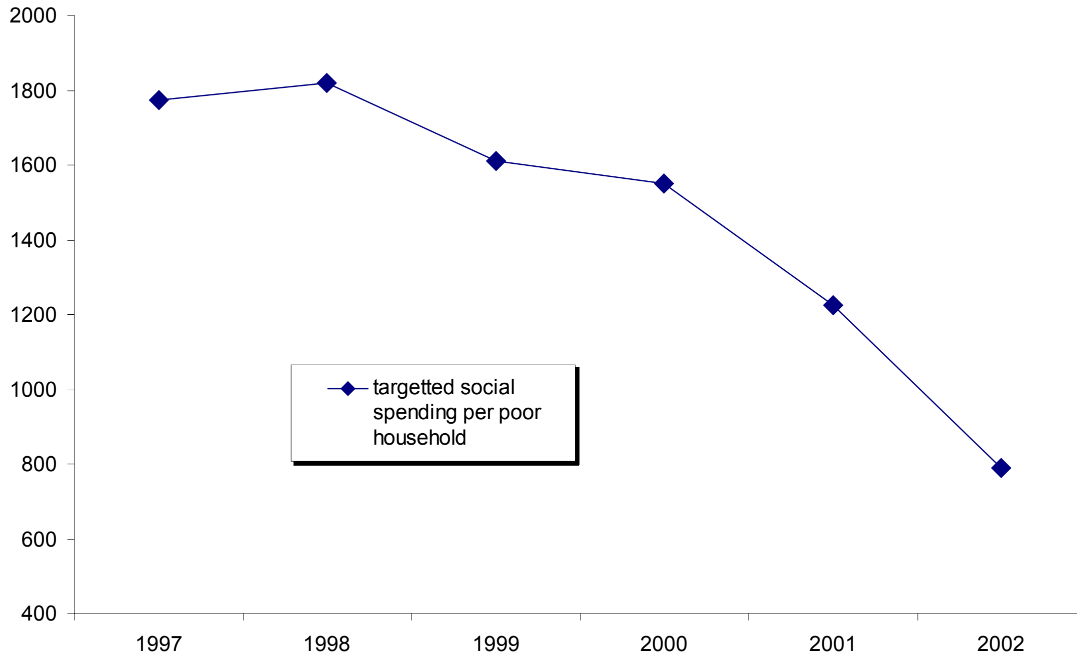

Figure 14

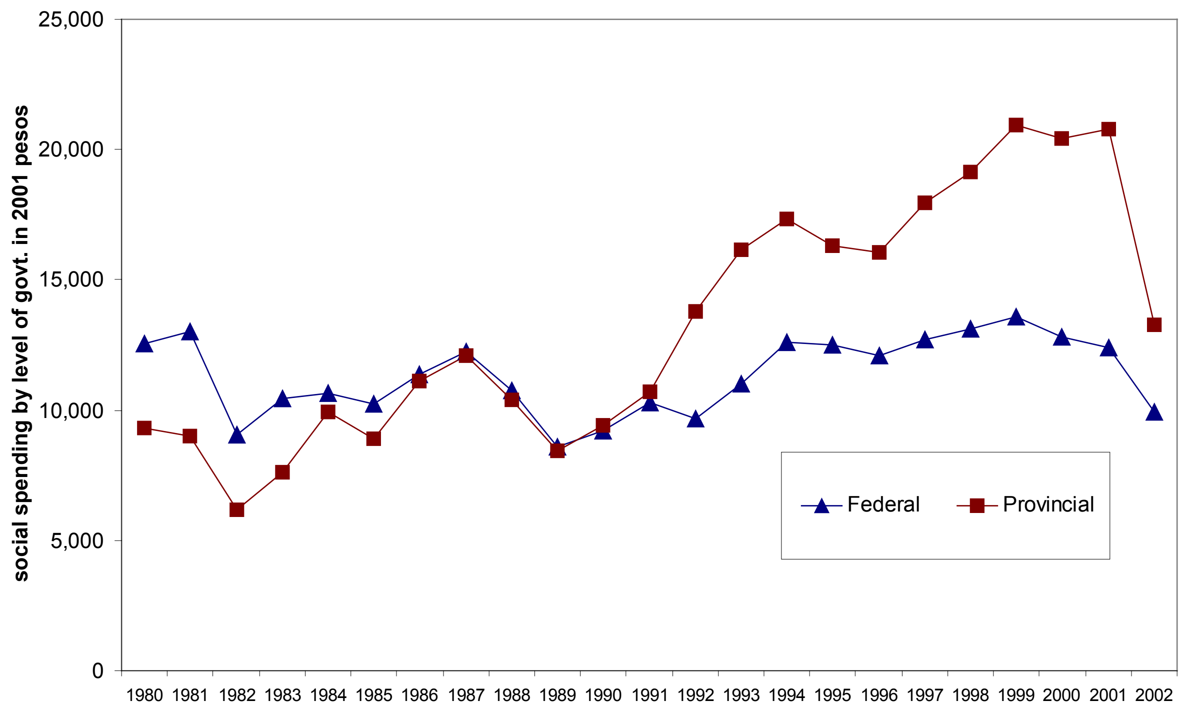

Figure 15

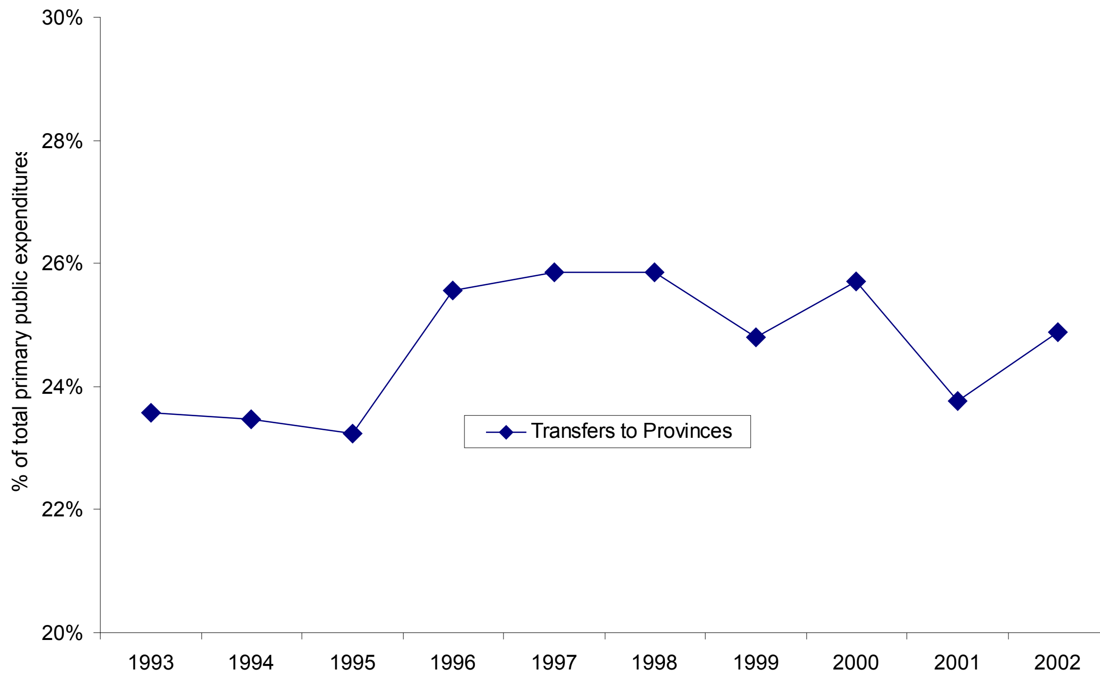

Figure 16

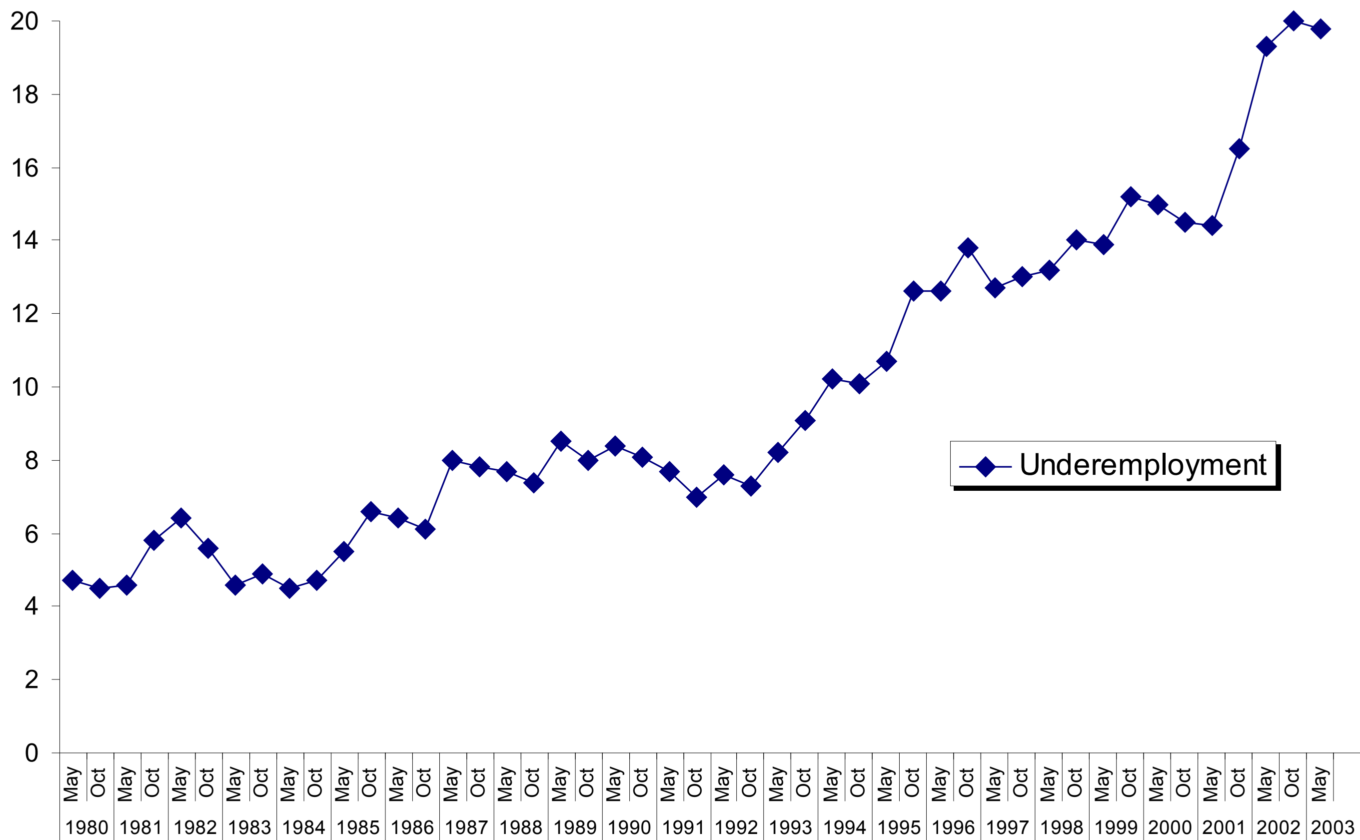

Figure 17