
From Captive to Failed State: Argentina under Systemic Populism, 1975-2006

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“Argentina . . . remains a land to be plundered; and its politics can be nothing but the politics of plunder.” —V. S. NAIPAUL¹

In little more than half a century, Argentina has suffered an almost unparalleled economic involution: the percentage of its population below the poverty line has risen steadily from approximately 10 percent circa 1950 to 45 percent in 2005.² This astonishing trend is the key datum from which any diagnosis of Argentina’s long-term economic and governability prospects must depart. It is the product of a process that has taken place under both democratic and military regimes and irrespective of which party governed while under constitutional rule.

Although many Third World countries have always had a similarly massive underclass, only Argentina has suffered such a regression. As would be expected, the deterioration of the social structure and living standards of the populace was accompanied by a severe erosion of the country’s institutions, the most dramatic illustration of which was the financial and political collapse of December 2001. This erosion has had serious security implications for Argentina. In this paper I will argue that the social involution can be traced to massive transfers of wealth from the tax-

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payer to private business through identifiable mechanisms that have been at work since 1975.

Since that time, a sort of “systemic populism” has prevailed during the periods of constitutional rule. While the poor are manipulated for electoral purposes through the handouts typical of classical populism, once political power is captured, it is invariably used for “right-wing populism,” which is

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characterized by the transfer of wealth to the government’s client business sectors. Military regimes have been able to skip the classical phase and go straight to right-wing populism, but essentially both democratic and military governments have been devoted to concentrating wealth among their clients in the bourgeoisie. The prevalence of these dynamics has been obscured by the understandable obsession of social scientists with democratic transitions in Latin America.

Both phases of populism are a part of a single, systemic whole. Following an Olsonian logic, the interests and behavior

of private firms that benefit from government sinecures are analogous to those of the workers and subsidized unemployed who transitorily benefit from electoral demagoguery.³ The populace rewards politicians with its vote and support at rallies. The crony business sectors reward them with electoral funds and bribes. The populace punishes politicians with strikes, protests, and roadblocks. The more powerful crony business sectors finance strikes and antigovernment rallies to punish unfriendly politicians in power.⁴

Succinctly stated, Argentina is a captive state in danger of failure. Most commentators have pointed to the country’s democratic advances since 1983 as a sign of progress, but the unhappy truth is that since at least 1975, its economic policies have been controlled by a powerful minority that is essentially looting the state for personal gain.

THE RODRIGAZO AND EMERGENCE OF THE *PATRIA FINANCIERA*

In 1975, under the presidency of María Estela Martínez de Perón, an unprecedented cycle of extreme monetary instability and speculation began. The long-term political and institutional consequences of this cycle have not been fully researched and understood by mainstream political sci-

entists. According to the Argentine Central Bank, yearly inflation, which averaged a very high 33 percent during the 1946–1974 period, jumped to an astonishing 206 percent over the subsequent eight years. Simultaneously, average yearly GDP growth decreased from 3.7 percent for the 1946–1974 period to 0.2 percent for 1975–1983.⁵

Indeed, the return to the presidency of Juan Perón two years before and the accompanying devolution of political power to the majority party, which had been proscribed for 18 years, generated the insurmountable inflationary pressures that came to the fore during his wife's presidency. These pressures resulted from the strong ongoing demand for subsidies for the client business sectors typical of right-wing populism as well as increased political pressure to expand public employment at both the national and provincial levels, which is typical of classical populism.⁶ In 1974, the pressures intensified after Perón's death and the succession of his widow to the presidency.

It is widely believed that around this time a powerful segment of the local bourgeoisie came to the conclusion that the only way to profit from the frustrating stalemate of Argentine politics was to wager on instability.⁷

ARGENTINE HEADS OF STATE FROM 1973 TO PRESENT

REGIME	YEARS	HEAD OF STATE
Constitutional	1973	Héctor J. Cámpora
	1973-1974	<i>Juan Domingo Perón</i>
	1974-1976	<i>María Estela Martínez de Perón</i>
Military	1976-1981	Jorge Rafael Videla
	1981	Roberto E. Viola
	1981-1982	Leopoldo Fortunato Galtieri
	1982-1983	Reynaldo Bignone
Constitutional	1983-1989	<i>Raúl A. Alfonsín</i>
	1989-1999	<i>Carlos Saúl Menem</i>
	1999-2001	<i>Fernando de la Rúa</i>
	2001	<i>Ramón Puerta</i>
	2001	<i>Adolfo Rodríguez Súa</i>
	2001	<i>Eduardo Camaño</i>
	2002-2003	<i>Eduardo Duhalde</i>
2003-	<i>Néstor Kirchner</i>	

NOTE: The names of leaders mentioned in this article are italicized.

Popular wisdom coined the ironic term *patria financiera* (fatherland of financiers) to refer to this segment of society, which emerged to take advantage of the measures implemented in 1975 by Minister of the Economy Celestino Rodrigo. His policies were actually crafted by experts such as Undersecretary Ricardo M. Zinn, who would soon become a key figure in the economic administration of the military regime. Indeed, there was remarkable continuity between the economic policies of Mrs. Perón and those of the subsequent military dictatorship.

The Zinn-Rodrigo emergency measures consisted of a mega-devaluation of 100 percent, a 175 percent increase in the price of petrol, and increases in the price of essential public services ranging from 75 to 120 percent, along with the cancellation of previously negotiated wage increases. Locally remembered as the “Rodrigazo,” these policies constituted the most massively regressive transfer of income in Argentine history.⁸ Moreover, recent research has suggested that the Rodrigazo itself was perpetrated with this goal very much in mind. According to recent interviews with several of Zinn’s advisors, it was the government’s intention to produce a profit-generating chaos:

The idea was to generate an inflationary stampede to depreciate the debts of private firms, shatter the price controls in force since 1973, and especially benefit exporters through devaluation. The explosion was on purpose. If the trade unions asked a rise of 80 percent, Zinn said we should offer them 100 percent. And he asked to add huge items to the national budget, just in case: “After all, the governors will later come with their demands and we will have to give in, so why not avoid the hassle.”⁹

Chaos was welcomed not only by speculators, but also by certain pro-market capitalists. They viewed the economic chaos as proof that interventionist policies are often counter-productive and that the market should therefore be allowed to work itself out, regardless of the social costs. Some in the government also found the chaos useful because it generated a perception of threat that provided justification for repressing the insurgent violence that had been unleashed by a combination of domestic and international factors, especially the proscription of the majority Peronist party from 1955 to 1973. It should be noted that the illegal repression of leftist militants associated with the military regime began during the constitutional governments of

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1973–1976. While Rodrigo and Zinn implemented their economic policies, the paramilitary Alianza Anticomunista Argentina (AAA) was busy abducting militants, something that was also altogether new in Argentine politics.

Thus, in the rationale for the Rodrigo-Zinn policies, the quest for security fed into the drive for profiteering. For strategically placed people with an expert knowledge of the economy, profiteering was a much safer way of making money than attempting to invest, increase productivity, and compete in an economy characterized by financial instability, distorted incentives, and obstacles to efficient investment.

From the Rodrigazo onward, astronomically high inflation led to the proliferation of speculative financial schemes that became a hallmark of Argentine financial life. Examples include the so-called *autopréstamos* (self-awarded credits), which were used widely during the 1976–1983 dictatorship. This particular scheme took advantage of the government's policy of providing exchange insurance to private firms seeking foreign financing. With the use of secret collateral, speculators effectively laundered money through foreign banks to make what appeared to be foreign loans to domestic companies, thereby qualifying for subsidized exchange insurance. Having transferred all exchange rate risk to the government, speculators were then in a position to profit from hyperinflation as it forced a decline in the exchange rate. Thus many influential operators had an incentive to pressure the government to seek the largest possible currency devaluation.

Despite differing monetary circumstances, essentially the same maneuver was implemented during the military regime and also during the later Menem administration. From the headquarters to the subsidiaries of foreign banks and multinationals, *autopréstamos* were used to take advantage of the gap between interest rates in Argentina and those in the advanced democracies. This was one of the most important mechanisms through which wealth was extracted and concentrated over a prolonged period of time.

Another method for generating huge financial gains, also inaugurated during the tenure of María Estela Martínez de Perón and subsequently used in each of the ensuing administrations, consisted of taking advantage of the gap between the market value of Argentine bonds and the value that the government was willing to attribute to them for diverse purposes. At times they were accepted as collateral for credits; during the 1980s they were used in debt capitalization operations; and during the 1990s they were accepted as payment for privatization deals. Needless to say, these deals were never available to everyone, but only to clients of the government or to people with the right contacts.

The mechanism for arbitraging bond prices originally consisted of buying bonds known as VANAS in a foreign market and depositing them as collateral for credits selectively granted by the Argentine government. Because the bonds were at times sold for as little as 5 percent of their face value, even though the government was willing to recognize their full face value and grant credits for up to 30 percent of this amount, the scheme was to exchange the bonds for loans that ultimately went unpaid. The loan proceeds would then be used to buy more bonds abroad that again were exchanged for credit. The operation would be repeated endlessly, and once again popular wisdom found an expression to refer to it: the *bicicleta financiera*, or “financial bicycle,” which made it possible for a privileged few to amass enormous wealth in very little time.¹⁰

TOWARD THE NATIONALIZATION OF PRIVATE DEBTS

These financial mechanisms contributing to the concentration of wealth were complemented by a new judicial doctrine that was allegedly rooted in principles of distributive justice. This doctrine held that it is unfair for private firms contracted by the state to suffer losses from financial instability or other unforeseen difficulties encountered while fulfilling their contracts.

In academic circles, this doctrine was championed by Rodolfo Barra, a jurist who later became a justice on the Supreme Court and also Minister of Justice under Menem.¹¹ Through the implementation of this judicial doctrine, it became possible to engage in big business with the Argentine state with virtually no entrepreneurial risk. Moreover, this legal—if per-

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verted—doctrine generated an illegal byproduct: the practice of drafting contracts with intentionally flawed specifications. In exchange for substantial payback, representatives of public firms would negotiate flawed contracts with private contractors. Once construction was under way, it would be “discovered” that the original plan had skipped crucial steps, increasing the costs substantially. Thanks to this doctrine, such cost

increases would inevitably be covered by the state, even if it later decided to challenge this in court. As a consequence, from then until the privatization of public firms in the 1990s, the typical Argentine public works proj-

ect cost approximately three times of what was established in the phony public tenders. Paradigmatic cases such as the hydroelectric project of Yacyretá cost over 12 times the original estimation. During this period a large gap emerged between the cost of public works in Argentina and the rest of the world.¹²

Not only did Argentina become a “captive state;”¹³ for all practical purposes its public firms became the private property of predatory contractors, which popular wisdom properly baptized as the *patria contratista* (fatherland of contractors), a complement to the *patria financiera*. Combined, they were the only real citizens of the “fatherland,” the sovereign minority in an unparalleled system of chronic regression and increasing social exclusion.

Two additional mechanisms contributed to making the private contractors’ lobby almost all-powerful in this exclusionary, covert political order. One was the award of Argentine treasury

guarantees to private firms that allegedly needed foreign credit to fulfill orders for public works. During the dictatorship of 1976–1983, major private contractors consistently failed to pay their creditors, and the Treasury picked up the bill. Although the contracts stipulated that in such circumstances the firm in arrears became a debtor of the state, the contract documents were often conveniently lost. Thus, the foreign debts of many of the major and more solvent Argentine companies were paid by the taxpayer.¹⁴

Furthermore, several of these firms were given a special waiver, legal in “extraordinary” circumstances under the Charter of the Central Bank, which exempted them from repaying the state for payments made by the Treasury to foreign creditors on their behalf. Because the original papers documenting these nationalized private external debts could not be found, by the end of the military regime, audits of the external debt were put under the control of PricewaterhouseCoopers, who relied heavily on the creditors to establish the monies owed to them—a method certainly unfavorable to the Argentine taxpayers. With slight variations, this situation continued through the Alfonsín and Menem governments.

Moreover, subsidized exchange insurance was reinstated starting in 1981, in response to the failure of the preprogrammed devaluation policy implemented in 1976 by Minister José Martínez de Hoz. This policy had

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amounted to free and automatic exchange insurance, encouraging *auto-préstamos* by the local branches of banks and multinationals.

The debates between Domingo Cavallo and José Luis Machinea¹⁵ about whose policy of private debt depreciation was more favorable to the national interest are illuminating. Cavallo was appointed president of the Central Bank in June 1982, near the end of the military dictatorship, and largely continued the depreciation policy implemented by his immediate predecessor. Machinea, the president of the Central Bank during the subsequent democratic administration of Alfonsín, also continued these policies. In his writings, however, Cavallo claims that his was a “good” debt depreciation because he refrained from nationalizing foreign debts. This limited the state’s support of debtors to the depreciation of their internal liabilities, which could be sorted out immediately through a symmetrical depreciation of assets in savings accounts. As a result, the burden was simply transferred to depositors, and would not be carried from one administration to another, as would be the case for policies that nationalized private external debts, like those implemented by Machinea.

Cavallo also claims that the nationalization of private external debts during the Alfonsín government was particularly unfair because it discriminated between big and small debtors, limiting the benefits to large firms that were friends of the administration. The colorful titles of the chapters of his book demonstrate that he matter-of-factly considered the depreciation of private debts, oblivious to the reality that more than half the population was not creditworthy and could not become indebted to the formal banking system. In such a context the depreciation of private debts is always regressive and leads to the concentration of wealth among a minority of the population. Here are some of the chapter titles:

1. “*Licucción al estilo de Brodersohn-Machinea: sólo para privilegiados*” (“Depreciation Brodersohn-Machinea style: only for the privileged”), which describes the “unfair” depreciation of private debts undertaken by the Radical Party’s administration;

2. “*Licucción a lo Alemann-Rossi: equitativa pero inflacionaria*” (“Depreciation Alemann-Rossi style: equitable but inflationary”), which describes an equally “bad” proposal of inflationary private debt depreciation, presented by conservative technocrats who were friends of the military and competed with Cavallo; and

3. “*Una licucción que desarma la trampa hiperinflacionaria*” (“A depreciation that disarms the hyperinflationary trap”), which describes the “good” debt-depreciation policy advised by the author, which allegedly had the added advantage of not being inflationary or discriminatory.¹⁶

As can be seen from the above, from this crucial point of view there was no real difference between the democratic government of Alfonsín and the previous military regime. The process of nationalizing foreign private debts that began under the dictatorship culminated in a new Central Bank policy, announced July 1, 1985. Creditors were given "Central Bank obligations" in exchange for what had previously been external private debt. *Clarín*, the Buenos Aires daily with the widest circulation, announced in a headline: "*El Estado asumió la totalidad de la deuda externa privada*" ("The state assumed responsibility for the entire private foreign debt").¹⁷

Simultaneously, as Cavallo was quick to denounce in his role of opposition congressman, new mechanisms for the depreciation of private debts and for otherwise subsidizing private enterprise were being put into place. One such policy consisted of the capitalization of external debt through the purchase by private firms of depreciated sovereign bonds that could be bought far below face value and converted into their full value for the purpose of purchasing capital goods.¹⁸

In 1988 the state once again paid for the foreign debt arrears of private firms holding Treasury guarantees. This time the guarantees had been awarded by the Alfonsín administration, which wanted to protect these firms from a possibly unfriendly future government. To this end, a governmental decree established that such businesses could repay the state with depreciated Argentine bonds whose market values were only 20 to 25 percent of face value. Although to no avail, Congressman Cavallo denounced the maneuver with thunderous speeches, despite its similarity to the policies he had implemented as head of the Central Bank in 1982. He eloquently declared that instead of planning the privatization of public companies, the government should privatize the private firms.¹⁹

Interestingly, everyone involved now acknowledges the problems inherent in these policies, although they inevitably lay the blame on political opponents. Indeed, in 1990 Machinea and Sommer recognized that:

The reduction of the external liabilities of the private sector was in actual practice achieved through a nationalization of a great part of that external debt. The external debt of the public sector, which was 53 percent of total debt in 1980, rose to 70 percent in 1983 and to 83 percent in 1985.²⁰

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Thus, as if no regime change had taken place, the debt of powerful private business firms continued to be transferred to ordinary taxpayers, with the obvious consequences of wealth concentration and poverty generation. Machinea, who was head of the Central Bank when this happened, later acknowledged in an English-language report to the World Bank that the economic culture of the Argentine bourgeoisie demanded the depreciation of private debts. He blamed Cavallo for the outbreak of the process:

The concessions made during (the dictatorship) were to affect the economic policy of the next years. Specifically, the reduction of private liabilities during 1982 was to leave behind a “syndrome of *liquidification*.” That is, anytime the real interest rate was quite high, expectations turned to “doing something in order to reduce the private debt.” . . . From then on the monetary policy lost part of its effectiveness because in many cases the response of the private sector to very high real interest rates was just to wait for the *liquidification*.²¹

ATTEMPTS AT ECONOMIC REFORM

As Javier Corrales notes, given the overwhelming lobbying power of the predatory private firms, it is not surprising that Minister Martínez de Hoz’s privatization program failed miserably.²² The public firms were covertly the property of the private contractors, and these contractors would not tolerate losing the sinecures of supplying materials to state-run companies. By 1981, the neoliberal privatization program was completely shelved.

Moreover, when the Alfonsín administration, overburdened by the failure of its economic policies, launched a strong privatization initiative in 1985, the private firms once again opposed it as a threat to their profitable business with the public firms. Both Corrales and Javier González Fraga have documented the similarity of boycotts led by private firms during the military regime and the Alfonsín government.²³ In 1988, Siderca, a subsidiary of the powerful Italian-Argentine conglomerate Techint, sold locally-produced standard steel tubes to a state oil firm for nearly two-and-a-half times the price at which Siderca had exported them. Moreover, its competitor supplying the state oil firm with these tubes was Propulsora Siderúrgica, also a subsidiary of Techint.²⁴

At an aggregate level, reports from early 1989 show that the over-billing of the state by private suppliers was approximately \$2.5 billion per year. Adding the special tax exemptions that totaled about \$2.2 billion per year, the overall subsidy was about 6 percent of the entire Argentine economy—and this doesn’t even include the benefits from the nationalization

and depreciation of private debts, or the profits accrued from financial maneuvers such as *autopréstamos*.²⁵

Unsurprisingly, when Alfonsín set out to privatize, the response was savage. The private firms financed strikes and opposition rallies. According to high-level trade union officials, who reported to Corrales on the condition of anonymity, the firms' deliberate intention was to lay off workers in order to generate unrest and destabilize the government.²⁶ In the diplomatic language of a professional economist, Machinea acknowledged that:

The private firms financed strikes and opposition rallies—[and had the] deliberate intention to lay off workers in order to generate unrest and destabilize the government.

In a country where fiscal subsidies . . . and a closed economy had almost suppressed private risk for so many years, it was logical to expect that the reaction of the entrepreneurs to . . . the elimination or reduction of benefits . . . would be quite strong. . . . Quite surprisingly, this reaction enjoyed, at least at the beginning, the "sympathy" of the population at large. Even more striking was the fact that some labor union leaders, together with the entrepreneurs, demanded tax reductions or tax exemptions.²⁷

Of the country's largest state-owned firms, Alfonsín only succeeded in reprivatizing Austral, a formerly private domestic airline. When weeks later he announced the intention of selling 40 percent of Aerolíneas Argentinas to Scandinavian Airways (SAS), he triggered a negative reaction. The new owners of Austral charged that the government had acted in bad faith and explained that while they were delighted to compete in the domestic market with a state firm, it was outrageous to have them compete against a private one. When Aerolíneas was finally privatized under Menem, the expectation was that Austral would be party to the Iberia-dominated consortium. Because the former did not have the money to pay for its share of the purchase, it was allowed to mortgage the Aerolíneas fleet before taking ownership and use the proceeds to pay for its stock.

This solution is paradigmatic of Menem's approach to privatization. As Héctor E. Schamis points out:

The distribution of rents through subsidies and public contracts could not continue, but at the time no government could afford the opposition of the large economic conglomerates, the corporate culture of which had been forged more in the political arena than in the marketplace.²⁸

During the first phase of the Menem administration, private contractors again laid off workers, financed strikes, and generated rumors of financial collapse. A prime example was the massive strikes against the privatization of the steelwork SOMISA, supported not only by the big contractors but also by many of the local private firms of the San Nicolás de los Arroyos area, where the plant is located.²⁹

It was after such policy trials and errors that Menem came up with a privatizing methodology that, as medication for the ills of the captive public firms, was possibly worse than the disease itself. Cavallo, who in 1991 became Menem's Minister of the Economy, was the chief author of the strategy. As Corrales candidly explains:

The crucial defection engineered by the administration was that of a few "*patria contratistas*." This was achieved by reordering property rights to make it extremely attractive for a few large *patria contratistas* to participate in the first round of privatizations. Alfonsín would have been content with securing a deal with foreign firms to take control of Aerolíneas and ENTel. But Menem wanted to neutralize his domestic saboteurs, and he figured that the only way to do this was to do whatever was necessary to get *patria contratistas* to buy. . . . Almost every privatization under Menem has included a domestic buyer. Of the 18 largest participants, seven are Argentine. . . . Between 1990 and 1995, more than half of Argentina's privatization revenue came from domestic capital.³⁰

On the basis of interviews with leading economists and Peronist Justicialist leaders, Héctor Schamis came to the conclusion that the only way the government could successfully privatize was to make the operation profitable for the local "captains of industry."³¹ A similar conclusion was reached by Ana Margheritis.³² It took a "reordering of property rights," inasmuch as without outright plunder it was impossible to make the purchase of captive public firms more profitable for the private contractors than it was to have them remain public. The profit had to be greater than the previous racket of gross over-billing, which was of course facilitated by such juridical fallacies as the doctrine that held that private contractors should not be held liable for losses accrued while executing public contracts.

This helps to explain why, in the privatization of the telephone monopoly, sovereign bonds worth only \$1.3 billion in the market were redeemed at their face value of \$5 billion. In more aggregate terms, according to official data processed by FLACSO, privatization carried out between 1990 and 1994 generated only \$10.4 billion in cash. In total, sov-

foreign bonds worth \$5.8 billion in the market were redeemed for their nominal value of \$13.6 billion.³³ This served the dual purpose of seducing both local saboteurs and foreign creditor banks, who since the 1976–1983 dictatorship had become a powerful force to be reckoned with, and who were suspected of being complicit in the brief outbreak of hyperinflation in 1990.³⁴

But the use of bonds in lieu of cash was not the only preferential treatment given to the buyers. During the several months prior to the actual transfer of the public companies, the state accepted the politically difficult task of increasing the tariffs of utilities. Telephone rates were increased seven-fold over ten months, and similar measures were taken with the waterworks and the state gas company.³⁵

The state retained the greater part of the debts owed by the privatized public firms. In several cases, these liabilities increased drastically in the months just prior to privatization, as if the private contractors were being given their last shot at over-billing the public firms. The debt of the state telephone company increased by 122 percent through contracts issued to private firms. This debt was taken over by the state in a new entity called “Residual ENTel.” Simultaneously, two of the private firms that benefited from these operations became members of the consortiums that soon were to be allotted ownership of the state monopoly.³⁶

Finally, there were no regulatory frameworks in place for the public services to be provided by the privatized companies. When they were eventually enacted, it was too little too late. In the case of Aerolíneas, this flaw made it possible to mortgage the airplane fleet as soon as the sale closed. Given the massive corruption characterizing its privatization, the Argentine case conforms fully to Joseph Stiglitz’s observation that a privatization process cannot be less corrupt than the elite that carries it out.³⁷

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FROM CAPTIVE TO QUASI-FAILED STATE

Fernando de la Rúa kept in place all the privileges granted by Menem to the newly privatized companies, whose foreign debt soared as a consequence of arbitraging the gap between interest rates in the advanced democracies and in Argentina, in a context of a one-to-one currency peg that was the equivalent of free exchange insurance.

During the first phase of the administration, Machinea headed the Ministry of the Economy with the full support of the former private contractors, now party to the ownership of the privatized companies. The minister had established strong ties with the Industrial Union, and especially with the Techint conglomerate, which was to the first stage of the De la Rúa administration what the Bunge and Born conglomerate had been to the initial phase of the first Menem government. Some of the officials that served with Machinea were drawn directly from the executive staff of Techint.³⁸

It is not surprising that even though the government coalition was an alliance between the center Radical Party and the left-of-center FREPASO, a labor reform advocated by the International Monetary Fund (IMF) and big business that was designed to make labor relations more flexible by reducing workers' benefits became one of the government's pet projects. Still, all hell broke loose when it was revealed that legislative support for the new law was being bought with numerous bribes, in an operation spearheaded by the left-of-center Minister of Labor.

The episode led to the resignation of the vice-president and was the beginning of the end for the De la Rúa administration, only half a year into its rule. But the most interesting outcome of the scandal was that, for the first time, a very senior senator acknowledged publicly that the purchase of laws was standard practice in Argentina. Suddenly, something previously only known to savvy political observers was out in the press.³⁹

The scandal not only illustrated the degree to which Argentina had become a captive state, but also suggested that in a political order in which government officials are aware that their main mission is to make the rich richer at the expense of ordinary citizens, they will demand their share in the loot. The episode is much more than an anecdote; it shows that the deterioration of political institutions is all but inevitable in a captive state governed by the rules of systemic populism.

After the scandal, the financial situation rapidly deteriorated. In 2001 Cavallo was summoned to mend the mortally wounded monetary order that he had launched several years before under Menem. He was granted extraordinary powers, including the ability to modify laws by decree. The newly appointed minister immediately set out to negotiate the so-called megaswap, whereby almost \$51 billion of sovereign debt was refinanced at a rate of 15 percent, with a sizeable commission paid to the banks that held many of these bonds.

According to the calculations of opposition Congressman Eduardo Di Cola, later corroborated judicially, Argentine debt was increased by

\$40.7 billion in order to postpone payments until 2005. Even though the swap alleviated the payment of almost \$13 billion between 2001 and 2005, during the subsequent five years the state would have to pay \$21 billion more than it would have had to pay without the swap. In other words, an abusive cost was accepted in order to overcome the government's short-term fiscal difficulties.⁴⁰

The megaswap is reminiscent of the Russian rescue package of 1998, only bigger.⁴¹ Although the Argentine government wanted to buy itself time, the outcome was essentially to allow profiteers to lead a massive foreign exchange flight, as well as provide an occasion for the banks and their agents to earn large fees. As Paul Blustein showed in *The Washington Post's* excellent piece of investigative journalism, entitled "Argentina Didn't Fall On Its Own," the investment banks deliberately concealed reports forecasting the inevitable collapse, with the intention of earning further commissions from the placement of Argentine bonds.⁴²

Although the megaswap might have been satisfying for the successors of the *patria financiera* (that is, the financial speculators), it was not enough for the industrial and agricultural segments of the bourgeoisie, whose lobbies were actively promoting a new wave of private debt depreciation. Contradicting his rhetoric when in the opposition, but perfectly in line with his policies when a public official, Cavallo launched subsidies for 43 different productive activities as soon as he was appointed. This was just the beginning.⁴³

The lobbyists knew that they would find sympathetic ears in the government. The Justicialist governor of the province of Buenos Aires, Carlos Ruckauf, had already taken steps to provincialize the debts of private firms with Banco de la Provincia. His policies were enacted by the provincial legislature with the support of lawmakers from all three major parties. The provincial law provided for the issue of a bond that replaced all debts in arrears by March 31, 2001, for a total of \$1.9 billion.⁴⁴ Since most observers agree that despite being poorer, the provincial and municipal states are captive to an even greater extent than the national state, this case implies that many similar unreported bailouts probably have taken place through provincial and municipal banks in the years since 1975.

Simultaneously with this provincial operation, the lobbyists became increasingly vocal at the national level. The powerful Francisco Macri, head of a conglomerate, said in a radio broadcast:

Drastic measures must be taken; for example, nationalize the private debt, a debt that the Argentine business sector has accumulated, paying absurd interests and confronting absurd difficulties.⁴⁵

Not surprisingly, he failed to mention that in a legal context that carries the concept of limited liability to an extreme, those debts were largely the product of creative accounting that led to capital flight. A large percentage of the money taken as credit by a firm often ends up abroad under the name of an individual, while the firm's liabilities grow insurmountable. Because this occurs simultaneously to a number of companies, together amounting to a critical portion of the economy, when catastrophe looms,

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As a case in point, take the emergency decree promulgated toward the end of 2001. Through complex mechanisms set forth in dozens of articles, it sought to nationalize \$70 billion of private liabilities. Debts to the state could not only be paid with depreciated sovereign bonds, but also with depreciated negotiable bonds issued in the past by the indebted firms themselves.⁴⁶ Furthermore, it was also accepted that the debts of private firms with private or public banks could be paid with depreciated sovereign bonds. The banks in turn would be compensated for this operation through the issue of a new public bond with a Treasury guarantee. Invoking principles of distributive justice and equality before the law, the benefits were generalized for all debtors, whether or not they were in arrears.⁴⁷

FINANCIAL AND INSTITUTIONAL CRISIS

Before the handouts of this decree could be fully implemented, however, crisis befell Argentina. On November 30, in the midst of widespread fears that the grossly overvalued peso would collapse, \$4 billion of liquid assets fled the country, unleashing a fatal stampede against the local currency. Severe withdrawal restrictions were imposed by Cavallo, freezing the \$62 billion deposited in the banking system. The IMF, the World Bank, and the Inter-American Development Bank (IADB) suspended their dis-

bursements, and suddenly Argentina was in the midst of a popular insurrection ably manipulated by political strongmen seeking the resignation of De la Rúa and Cavallo, the end of the one-to-one currency peg system established in 1991 by Cavallo when he served under Menem, and a generalized default on the public foreign debt. There was rampant looting of retail businesses in the greater Buenos Aires area and in the Federal Capital. The Ministry of the Economy was set on fire by forces loyal to Justicialist strongman and future president Eduardo Duhalde.⁴⁸ Cavallo resigned on December 19, with De la Rúa following the next day.⁴⁹

During the next few weeks, Argentina behaved like a fully failed state. On December 21, the Legislative Assembly appointed Adolfo Rodríguez Súa president and gave him a constitutional mandate to govern until the end of De la Rúa's original term, although with a political agreement to hold presidential elections in March 2002. With overwhelming legislative support, the new president defaulted on \$132 billion of debt, the biggest default in history. When Rodríguez Súa began to waver in calling for elections, however, the same forces that had manipulated popular wrath against De la Rúa turned on him. On December 29, young protesters broke into and vandalized the National Congress building. *Clarín* titled the news item "*Noche de Terror en el Congreso*" ("*Night of Terror in Congress*"). The huge and heavy gate, which was not damaged, was opened from within. When the president called a meeting of governors in the presidential country house of Chapadmalal, he was deprived of his bodyguards and found that running water and electric power had been cut off.⁵⁰

What happened illustrates the erosion of federal institutions, which were breaking down into a constellation of territorially anchored power hubs. Chapadmalal was under the jurisdiction of the governor of the province of Buenos Aires, and in that location the provincial police were in charge of the president's security. Both the police and the governor responded to the forces that wanted Rodríguez Súa out. The president was safe only in his native province of San Luis, but he could not rule from there. This segmentation of power is perhaps the most significant indicator that Argentina was on the verge of becoming a full-fledged failed state. *The New York Times* warned that some provinces might seek secession.⁵¹

On December 30, Rodríguez Súa fled to his home province and resigned. The president of the senate and constitutional successor also fled to his own home province and resigned. Thus, Eduardo Oscar Camaño, president of the Chamber of Deputies, became provisional president and, as such, the constitutional link allowing for anointment by the Legislative Assembly of the real strongman, Duhalde. Duhalde immediately

appointed Jorge Remes Lenicov as minister of the economy and had congress enact a law declaring a public emergency and empowering him to unilaterally modify economic rules and devalue the currency.

The value of the U.S. dollar was quickly established at 1.40 pesos. Deposits were converted into pesos at this rate, but debts with banks, large and small, were converted at a one-to-one rate. This expropriation, which benefited debtors massively, would have been crippling for the banks were it not for other compensation provided them, to be financed through taxation of oil exports, bonds ultimately financed by taxpayers, and the partial expropriation of frozen deposits. As always, debtors thrived while the savings of depositors were looted. Thus, the nationalization of private debts, massively orchestrated to an extent that not even De la Rúa had dreamed of, became the law of the realm. In an instant, two billion pesos were transferred to 25 privatized (formerly state-run) firms, which were among the 50 most indebted private businesses in the country.

Between January and October 2002, notwithstanding the ostensibly severe controls imposed on capital transfers, over \$19 billion fled the country. The magnitude of this figure can be appreciated by comparing it to the \$13.8 billion trade surplus. Some \$9.4 billion of the fleeing capital did so under the guise of loans to foreign countries, as if Argentina were a developed state that sought to export capital. The truth of the matter is the capital flight was largely composed of a new variety of *autopréstamos*. The greater part of the flight capital, over \$12 billion, belonged to exporting firms and privatized companies.⁵²

With this increased concentration of wealth, Argentina found a new economic stability that allowed the partial reconstruction of its political institutions under presidents Duhalde and Néstor Kirchner. Thus Argentina moved away from being a failed state, although it continues to be a captive state ruled by systemic populism.

Kirchner, a Patagonian strongman who had scarce support at the national level, was elected in 2003 with the help of Duhalde's then-powerful political apparatus, which used the financial resources of the federal government, client picketing organizations subsidized by the administration, and his wife's *Manzaneras*, a network of militant female social workers dedicated to proselytism through the distribution of favors. After installation as president, Kirchner was able to consolidate his independence from his former political boss. In the legislative elections of October 2005, the main duel was between Kirchner's wife, Cristina, and Duhalde's wife, Chiche. During the campaign, these two competing Justicialist factions gave out appliances such as refrigerators and washing machines, as

well as checks for as much as 500 pesos, to buy the support of petty chieftains in the impoverished neighborhoods of greater Buenos Aires.⁵³

Mrs. Kirchner won by a large margin, aided by the resources of an administration that was strengthened thanks to the high prices of commodity exports. But as soon as its electoral legitimacy had been settled, the government reverted to right-wing populism and started consolidating its other power base by distributing subsidies among loyal business sectors.

SYSTEMIC POPULISM TODAY

These days there is a precondition for access to these subsidies: cooperation with the administration's anti-inflationary policy through "voluntary" price controls. Massive poverty as never before seen in Argentina is strengthening classical populism. The relatively new picketing organizations of the unemployed, which were instrumental to the downfall of presidents De la Rúa and Rodríguez Sáa, must be kept satisfied. They are a constant reminder that Argentina is close to the failed state syndrome. Controlling them requires a little money, although much less than is usually spent for right-wing populism, but a great deal of tolerance for their frequent law-breaking, which results in double-standards in law enforcement.

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Piquetero leaders who destroyed a police station (and more), were not only not arrested, they were even allowed to become lawmakers and government officials. In this way, the institutional order has further eroded.⁵⁴

Concomitantly, the mechanisms of right-wing populism are also in place. Subsidized credit lines for productive investments through Banco de la Nación have already been announced. Friends of the government who buy ten tractors are likely to end up paying only for six; such trends will probably lead once more to increased income concentration and poverty. Industrial subsidies are also at work through several other mechanisms. Not surprisingly, Héctor Méndez, the president of Unión Industrial Argentina, has declared, "we have never felt as protected as today."⁵⁵

There is also once again ample room for financial speculation, considering that some new bonds are offering an interest rate of over 13 percent,

while the currency has remained relatively stable at approximately three pesos per U.S. dollar for well over a year. But perhaps of the greatest significance is the new wave of public firms: the Post Office and the Buenos Aires waterworks (Agua Argentinas) have been renationalized, and a new state oil firm has been established to “recover oil profits for the nation”—allegedly to reverse the consequences of the sale of YPF to the Spanish firm Repsol during the 1990s. It is only to be expected that soon a descendant of the *patria con-tratista* will be in place, repeating the experience of the 1970s and 1980s.

Argentina is geographically almost the size of India, with a population 28 times smaller, yet by the time of the collapse of late 2001, it had accumulated more than twice the amount of India's foreign debt. Notwithstanding the size of Argentina's foreign debt, if the foreign assets of Argentine individuals were added to the national accounts, it would be a net creditor.⁵⁶ The most parsimonious explanation of this paradox is that too many powerful sectors, both indigenous and foreign, have made their day through the mechanisms described in this paper.

Because they have become embedded in the political system, these mechanisms are extraordinarily difficult to deactivate. Hence, the cycles that have generated Argentina's half-century regression, and which have multiplied the percentage of Argentina's poor by a factor of four, will probably repeat themselves. The greater the percentage of the poor, of course, the more difficult it becomes to govern the state. Eventually the deterioration of political institutions may become increasingly critical, with unpredictable security consequences at the national and regional levels. In the meantime, however, there is still some room for milking the cow. ■

ENDNOTES

- 1 V.S. Naipaul, “Argentina: The ghost of Eva Perón,” in *The Writer and the World: Essays* (New York: Vintage Books, 2003), 346.
- 2 Gino Germani pioneered the study of Argentina's social structure and its evolution. His key works on the subject were *Política y Sociedad en una Época de Transición* (Buenos Aires: Paidós, 1962) and his “Appendix” to the Spanish-language edition of Seymour Martin Lipset and Reinhard Bendix, *Social Mobility in Industrial Society* (Buenos Aires: EUDEBA, 1962). Estimations of Argentina's per capita GDP in 1937 and 1950, as compared to Western Europe, Japan, the United States, and Canada, are available in Alfred Maizels, *Industrial Growth and World Trade* (Cambridge: Cambridge University Press, 1963). Estimates of the purchasing power of the unskilled laborer in Argentina in 1941, as compared to the United States, Britain, France, Germany, Russia, and Italy, can be found in Torcuato Di Tella, “¿Cómo vive el obrero en la industria argentina?” *Revista de Economía Argentina* 271 (1941). Comparative Gini indices in 1960 for Argentina, Australia, Canada, the United Kingdom, the United States, and Holland (among other countries) can be found in Shail Jain, *Size Distribution of Income* (World Bank, 1976). Important data on comparative salaries and living standards for 1900–1930 are also offered by Carlos Díaz-Alejandro in his classic *Essays on the Economic History of the Argentine Republic* (New Haven: Yale University Press, 1970), 40–65. More recent studies on Argentina's

- social structure and its evolution include Jorge Raúl Jorrot and Ruth Sautú, eds., *Después de Germani: Exploraciones sobre Estructura Social de la Argentina* (Buenos Aires: Paidós, 1992); Susana Torrado, *Estructura Social de la Argentina, 1945-1983* (Buenos Aires: Ediciones de La Flor, 1992); and Artemio López and Martín Romeo, *La Declinación de la Clase Media Argentina: Transformaciones en la Estructura Social, 1974-2004* (Buenos Aires: Libros de eQuis, 2005).
- 3 Mancur Olson was a leading economist who focused on the logical basis of interest group membership and participation. See his *The Logic of Collective Action* (Cambridge, MA: Harvard University Press, 1965).
 - 4 This phenomenon is illustrated by Javier Corrales in "Coalitions and corporate choices in Argentina, 1976-1994: the recent private sector support of privatization," *Studies in Comparative International Development* 32 (4) (Winter 1998). For a previous period, the formulation by Guillermo O'Donnell in "State and alliances in Argentina, 1956-1976," *Journal of Development Studies* 15 (1) (October 1978) is also useful. See also S. Hanke and S. Walters, "Privatization and public choice: Lessons for the LDCs," in D. Gayle and J. Goodrich, eds., *Privatization and Deregulation in Global Perspective* (New York: Quorum Books, 1990).
 - 5 See José Luis Machinea, "Stabilization under Alfonsín's government: a frustrated attempt," *CEDES, Document 42*, 1990, 135.
 - 6 See Mario Damill and Roberto Frenkel, "Malos tiempos: la economía argentina en la década de los ochenta," *CEDES Document 46*, 1990, 6.
 - 7 I was first made aware of the intentional quest for instability by Cristóbal Williams and Luis Eduardo García. As a consequence, I interviewed six well-known financial operators.
 - 8 See Daniel Muchnik, *Argentina Modelo: de la furia a la resignación; Economía y política entre 1973 y 1998* (Buenos Aires: Manantial, 1998), 84-88.
 - 9 Néstor Restivo and Raúl Dellatorre, "El Rodrigazo, 30 años después," (Buenos Aires: Capital Intelectual (Colección "Claves para Todos"), 2005), 24-27. In 2005, the thirtieth anniversary of this episode, interesting testimonies were published in the Buenos Aires press. See the *Cash* supplement of *Página 12*, June 5, 2005.
 - 10 See Daniel Muchnik, *La Patria Financiera* (Buenos Aires: Norma, 2005), 189; and Restivo and Dellatorre, 26-27. See also my forthcoming *Festival de Licuaciones: Causas y Consecuencias de la Pobreza en la Argentina 1975-2005* (Buenos Aires: Ediciones Lumière, 2006).
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 - 15 President of the Central Bank during Alfonsín's government, and Minister of the Economy during the administration of De la Rúa.
 - 16 Domingo F. Cavallo, *Economía en Tiempos de Crisis* (Buenos Aires: Editorial Sudamericana, 1989), 19-20.
 - 17 *Clarín*, July 2, 1985.
 - 18 Cavallo, 73-76. See also Bouzas and Keifman, "El menú de opciones y el programa de capitalización de la deuda externa argentina," *Desarrollo Económico* 29 (116) (January-March 1990): 451-476; ECLA, "Las empresas transnacionales de una economía en transición: la experiencia argentina en los años ochenta," *Estudios e Informes de la CEPAL* 91, Santiago de Chile, Economic Commission for Latin America and the Caribbean, June 1995; Daniel Azpiazu, "La inversión en la industria argentina: el comportamiento heterogéneo de las principales empresas en una etapa de incertidumbre macroeconómica (1983-1988)," *CEPAL, Documento de Trabajo 49*, 1993, Section VI.4; and Andrés Cisneros and Carlos Escudé, eds., *Historia General de las Relaciones Exteriores de la República Argentina*, Tomo XI, *Las Relaciones Económicas Externas, 1943-1989*, 296.

- 19 Speech on December 7, 1988, at the Chamber of Deputies. Cavallo, 83–84.
- 20 José Luis Machinea and Juan F. Sommer, “El manejo de la deuda externa en condiciones de crisis de balanza de pagos: la moratoria 1988–89,” *CEDES*, Document 59, 1990, 4.
- 21 See José Luis Machinea, “Stabilization under Alfonsín’s government: a frustrated attempt,” *CEDES*, Document 42, 1990, 6.
- 22 Corrales, 1998, 2.
- 23 Javier González Fraga, “Argentine privatization in retrospect,” in W. Glade, ed., *Privatization of Public Enterprise in Latin America* (San Francisco: International Center for Economic Growth, 1991).
- 24 Corrales, 1998, 6.
- 25 J.L. Rowe, “Argentina’s reform goes awry,” *The Washington Post*, April 23, 1989; A. Bocco and Gastón Repetto, “Empresas públicas, crisis fiscal y reestructuración financiera del Estado,” in Arnaldo Bocco and Naum Minsburg, eds., *Privatizaciones: reestructuración del Estado y de la sociedad. (Del plan Pinedo a los Alsogaray)* (Buenos Aires: Ediciones Letra Buena, 1991); cf. Corrales 1998, 7.
- 26 Interview by Javier Corrales on August 7, 1991 in Corrales, 1998, 5.
- 27 José Luis Machinea, “Stabilization under Alfonsín’s government: a frustrated attempt,” *CEDES*, Document 42, 1990, 131.
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- 32 Ana Margheritis, *Ajuste y Reforma en la Argentina (1989-1995)* (Buenos Aires: Grupo Editor Latinoamericano, 1999), 101. This book is a translation of her University of Toronto Ph.D. dissertation.
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- 35 Basualdo and Aspiazú, 23–24.
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- 37 Joseph E. Stiglitz, *Globalization and its Discontents* (New York and London: WW. Norton & Co., 2002), 58.
- 38 For example, Javier Tizado, Gonzalo Martínez Mosquera, and Eduardo Casullo.
- 39 See Joaquín Morales Solá, “Carencias y defectos del gobierno,” *La Nación*, June 25, 2000; “Los políticos desfilan por la TV, pero no ante los tribunales,” *La Nación*, December 17, 2003; “El caso marca el fin de una era política en la Argentina,” *La Nación*, December 13, 2003; and the same author’s book, *El Sueño Eterno* (Buenos Aires: Planeta-La Nación, 2001).
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- 42 Paul Blustein, “Argentina Didn’t Fall on Its Own—Wall Street Pushed Debt Til the Last,” *The Washington Post*, August 3, 2003.
- 43 See *Clarín*, March 22, 2001.
- 44 M. Seoane, *El Saqueo de la Argentina* (Buenos Aires: Sudamericana, 2003), 239–240.
- 45 *Clarín*, October 24, 2001.
- 46 Roberto Navarro, “Ni Monedas,” *Página 12*, *Cash* supplement, October 28, 2001.
- 47 H. Verbitsky, “Oh no, lo hizo de nuevo!,” *Página 12*, December 9, 2001.

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- 49 On May 18, 2002, *Clarín* published an authoritative investigation revealing the organization and logistics of the politically motivated looting leading to De la Rúa's resignation, titled "*La Trama Política de los Saqueos*." Mafia-led government is not surprising in the Argentine context, even if it had never surfaced before. It is a fact known not only to local insiders but also to academic researchers that the grassroots organization of the Justicialist Party, especially in the Greater Buenos Aires area, is linked to criminal organizations. In the words of Steven Levitsky: "There is a dark underside to (Peronism's) social embeddedness. Because urban slum zones are frequently centers of illicit activity such as drug-trafficking, prostitution, and gambling, Peronist networks are inevitably linked to these forms of organisation as well." Although verifiable data on illicit Peronist activity is difficult to obtain, it is widely believed that Peronist factions in La Matanza are linked to drug running, gambling, prostitution, and extortion networks. For example, networks of temporary workers in La Matanza's Central Market, which are regularly mobilised by Peronist factions to paint graffiti and attend Justicialist Party mobilisations, are also rumored to be involved in drug trafficking and thug work, including the beating of a journalist who was writing a book on (former) Buenos Aires Governor Eduardo Duhalde. See S. Levitsky, "An 'Organised Disorganisation:' Informal Organisation and the Persistence of Local Party Structures in Argentine Peronism," *Journal of Latin American Studies* 33 (February 2001): 41.
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