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Elite Politics and Economic Crisis: Hyperinflation in Argentina, 1989-1991

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Abstract

Abstract: Hyperinflation is a rare form of macroeconomic crisis that often results from extreme political events, such as revolution or regime change. The 1989–1990 Argentine hyperinflation is puzzling because it occurred in the absence of such an event. Moreover, conventional fiscal mechanisms linking political processes to hyperinflation do not sufficiently explain the Argentine case. Previous theories emphasizing distributional conflict and institutional weakness contain key elements of an explanation of the Argentine hyperinflation, but do not capture the range of mechanisms that produced extreme financial instability. This paper offers an elite theory approach that subsumes elements of these approaches within a broader theory of elite fragmentation, competition and conflict. Elite fragmentation inhibits collective action in both economic and state elites, resulting in deficits in policymaking capacity. Fragmentation among state policy elites leads to policy volatility and incoherence, while fragmentation among politically mobilized economic elites results in elite stalemates constraining the options of policy elites. These policymaking patterns lead to prolonged delays in the adjustment of unsustainable organizational structures, resulting in explosive forms of crises.

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Hyperinflation is an extreme financial event in which the value of money collapses as prices increase rapidly. States create money and hyperinflation thus ensues from underlying political processes. Most historical episodes of hyperinflation occurred due to fiscal crises resulting from state breakdown, revolution and regime change: classic cases include the German Weimar Republic and the French Revolution (Fischer et al., 2002). However, in 1989 and 1990, Argentina experienced hyperinflation in the absence of such an extreme political event. Over two wave-like crises, prices increased at a monthly rate exceeding 50 per cent and annual inflation reached 3,000 per cent in 1989 and more than 2,000 per cent in 1990. This macroeconomic crisis was also a deep social crisis, leading to widespread shortages, lootings and civil unrest. Why Argentina experienced such an extreme macroeconomic event in the absence of a deep political crisis is a puzzle.

The Argentine case also defies the conventional fiscal mechanism linking political processes to macroeconomic outcomes as its hyperinflation did not occur primarily due to unconstrained monetary emission (“printing money”) to cover conventional fiscal deficits (c.f. Beckerman, 1995). Financial, rather than narrowly fiscal, mechanisms caused hyperinflation in Argentina. Modern fiduciary currency is sovereign debt: most money takes the form of bank deposits ultimately backed by the ability of financial institutions to transact with the state in the form of a national central bank (Ingham, 2005). Hyperinflation resulted in part from financial processes which rendered the Argentine state, and more specifically its Central Bank, effectively insolvent. In parallel, currency runs resulting from collective uncertainty among wealth holders were key causal factors. Hyperinflation resulting from these financial dynamics requires a different account of the political processes generating macroeconomic imbalances.

Plausible existing explanations for macroeconomic instability invoke institutional weakness (Levitsky and Murillo, 2005; Spiller and Tommasi, 2007) and distributional conflict (Alesina and Drazen, 1991). This paper offers an alternative explanation that subsumes elements of these theories within a broader account of elite politics. Hyperinflation in Argentina resulted from generalized elite fragmentation, which created a deep deficit in elites’ capacity to formulate coherent policy. Multiple distinct elite sectors — party, policy and economic elites — were internally fragmented, undermining their capacity for coherent collective action. This elite fragmentation generated volatile,

delayed, incoherent and contradictory economic policies, which in turn fomented macroeconomic instability. Incoherent policies allowed macroeconomic and financial imbalances to accumulate, rendering the Argentine state effectively insolvent.

The paper rests on a narrative account of policymaking episodes drawing on archival and interview evidence, including 27 interviews with elites and other contemporary observers. In addition, I draw on publicly available interviews,¹ published and unpublished documentary evidence, macroeconomic data and a systematic review of major newspapers.

1 Institutional weakness and distributional conflict theories

Many researchers claim that persistent macroeconomic instability in Argentina results from weak state institutions (Levitsky and Murillo, 2005; Dornbusch and de Pablo, 1989; Spiller and Tommasi, 2007; Grimson et al., 2012; Brinks et al., 2020). This is undoubtedly true but also a truism: institutional weakness has many dimensions and the mechanisms linking these dimensions to macroeconomic instability are poorly specified. The Argentine state bureaucracy — the institutional domain most relevant to macroeconomic policy — ranks low on measures of bureaucratic quality, such as staff turnover and tenure length (Evans and Rauch, 1999; Spiller and Tommasi, 2007). However, the mechanisms linking these general institutional indicators to macroeconomic outcomes have not been carefully specified. The concept of “corporate cohesion” (Evans and Rauch, 1999) is too vague to provide a precise explanation. One suggestion is that rapid turnover among state officials leads to short time horizons and undermines policy continuity (Dornbusch and de Pablo, 1989; Spiller and Tommasi, 2007). The elite politics account presented below incorporates this proposal while also recognizing that this is only one mechanism among several, and that elite turnover is often an endogenous reflection of elite conflict.

Other theories posit that distributional conflict is a key cause of macroeconomic crises and inflation (Hirschman, 1981; Krippner, 2011). One prominent distributional theory is the “war of attrition” model (Alesina and Drazen, 1991), which posits that explosive crises occur because conflict between competing groups leads to delay in the elimination of unsustainable fiscal deficits. In this model, groups with opposing economic interests compete to determine the magnitude of

the state's fiscal deficit. Even if these groups agree in principle on eliminating the deficit, they disagree on how this objective is to be achieved (e.g. budget cuts versus tax increases). Each group attempts to avoid costs by shifting the burden of adjustment onto the other; this conflict delays correction of the fiscal deficit until the crisis reaches a breaking point. Stabilization occurs when one party consolidates political control and forces the other to bear a disproportionate burden of adjustment. Alesina & Drazen (1991, p. 1173) cite Argentine monetary instability as an exemplary case, but do not provide systematic historical evidence.

Like institutionalist accounts, distributional conflict theories contain aspects of an explanation for the Argentine hyperinflation. Hyperinflation resulted in a sense from latent distributional conflict and a political impasse which delayed the elimination of unsustainable policies. However, the model's fiscalist assumptions are not met: as noted, the root causes of hyperinflation were financial (operating through the banking system and exchange rate market) rather than strictly fiscal (operating through the balance of state revenue and spending), requiring a different account of the underlying political processes. More fundamentally, the war of attrition model treats state elites as conduits for the interests of social groups, rather than elite actors pursuing their own objectives. This is an implausible assumption: Argentine political parties did not consistently represent specific economic sectors, and policy elites did not consistently represent party elites. Thus, the account presented here subsumes elements of both institutionalist and distributional conflict theories into a broader elite politics account.

2 Elite politics: fragmentation, stalemate and the policymaking process

Elite theory posits that relations between heterogeneous sets of powerful actors are crucial causes of economic and political outcomes (Lachmann, 2002, 2020). This contrasts with theories emphasizing such factors as public opinion, electoral competition and mobilization by non-elite actors. By spanning multiple elites, elite theory can encompass both theories of distributional conflict and weak institutions, which involve economic and state elites, respectively. Further, elite theories seek

to anchor analysis in terms of identifiable actors, rather than abstract aggregates such as classes or “the state” (Marcus, 1983). Conflict can arise not because individual elites represent underlying social groups, but because of the relations between particular elites pursuing distinct goals and strategies. Elite theories also often invoke the interrelated concepts of elite unity (Mills, 1956), cohesion (Burris, 2005), integration (Higley et al., 1991), fragmentation (Mizruchi, 2013) and stalemate (Lachmann, 2020) developed below.

The core claim of this paper is that elite fragmentation undermines elite policymaking capacity, leading to economic instability. This is an extension of Lachmann’s dictum that “elite conflict is the primary threat to elite capacities” (2020, p. 31). The concept of fragmentation summarizes several dimensions of relations among state and economic elites. The next section defines cohesion and fragmentation in network theoretic terms and identifies three dimensions of cohesion in state elites: relations between party and policy elites, among incumbent policy elites and between groups of policy elites over time. The following section describes elite fragmentation among economic elites and the concept of elite stalemate. The final theoretical section illustrates the consequences of elite fragmentation, defining five mechanisms through which generalized elite cohesion undermines policymaking capacity and produces instability.

2.1 Cohesion and fragmentation in state elites

State elites are individuals occupying elected or appointed positions in organizations conferring control over state policies and resources. Party and policy elites are two analytically distinct categories of state elites. Party elites are “politicians”: individuals who primarily acquire power through competition for elected office in association with a political party.² Policy elites are unelected occupants of state positions conferring direct policy authority. In many states, party elites substantially delegate direct decision-making authority over economic policy to policy elites, giving them considerable autonomy (Huber and Shipan, 2002). For example, heads of state delegate substantial control over economic policy to finance ministers, central bankers and occupants of other key state offices.

Elite cohesion shapes state actors’ capacity for collective action and coherent policymaking

(Centeno, 1997; Evans, 1995; Van Gunten, 2015). Cohesion is a multidimensional concept (Moody and White, 2003); here I define elite cohesion in terms of the structure of informal elite networks. Elites participate in sustained relationships that facilitate trust and cooperation (or “social capital”) in state careers and policymaking processes. Network ties help coordinate the action of heterogeneous elites by building informal coalitions within and beyond the state. These networks constitute an informal social structure underlying the formal organizational structure of the state.

In network theory, cohesion is a feature of patterns of relationships. Specifically, a cohesive network is held together by multiple independent paths, while a fragmented elite lacks such paths (Moody and White, 2003; Van Gunten, 2015). Network cohesion depends on the level and organization of clustering; clusters are sub-groups of a network with many connections within latent group boundaries but few connections across clusters. In a cohesive network, clustering patterns congeal into a single, densely-connected network community. In a fragmented network, there are many different clusters which may (or may not) be internally cohesive, but which lack dense connections to other clusters.

Three key dimensions of cohesion and fragmentation among state elites are most relevant here. The first dimension concerns relations between party and policy elites. In some regimes, policy elites are embedded within party organizations, creating cohesive networks binding party and policy elites. For example, parties with well-developed economic advisory roles in electoral campaigns and other sub-units foster ties between policy and party elites.³ In other regimes, party elites recruit policy elites outside of party organizations, and relations between party and policy elites are arms-length and instrumental. The former reflects a situation of elite cohesion among party and policy elites, while the latter can result in fragmentation among these two elite segments.

The second dimension concerns cohesion among incumbent policy elites that are active at the same time (synchronic cohesion). Inter-organizational cohesion, or the structure of relations between state organizations, is one aspect of this dimension (Van Gunten, 2015). States consist of multiple organizations with inter-related policy jurisdictions (for example, finance ministries and central banks). These organizations themselves have complex internal structures with multiple internal sub-units, and operational organizations coexist with high-level advisory bodies. Elites

within these multiple organizational hierarchies may inhabit a well-connected, cohesive elite network, or may fragment into disjointed organizational silos. Cohesive networks across these entities facilitate communication, joint formulation of priorities and plans, and prevent conflict. In contrast, fragmentation fosters internal competition and even outright factional conflict among informal elite networks.

Third, elite cohesion has a temporal dimension. Electoral calendars and other political cycles generate high-level elite turnover in modern states. Most obviously, alternation between political parties usually leads to changes in state personnel, but changes in governing party are not the only cause of elite turnover. For example, even in relatively stable elites, within-period cabinet-level changes are common. In a cohesive elite, changes of elite personnel are relatively fluid and decoupled from policy change; turnover is often a vacancy chain process (White, 1970) in which deputies move into their former superiors' positions.⁴ In a fragmented elite, elite turnover often involves shifts in control between competing networks. New appointees bring their own networks of loyal subordinates and high-level change thus cascades through administrative levels, making turnover events large-scale changes with new elites imported into the state displacing incumbents. Moreover, fragmented elites generate higher rates of turnover because elite conflict is a frequent cause of high-level resignations.

As noted above, institutional theories invoke elite turnover as a determinant of state incapacity (Evans and Rauch, 1999; Spiller and Tommasi, 2007), but the mechanisms linking these are poorly defined. Sociological institutionalists argue that career stability is a proxy for competence and "corporate coherence", which instills shared norms and discourages malfeasance. However, normative anomie and corruption have limited explanatory purchase on policy outcomes. Mechanisms specified below posit a role for elite turnover that does not rely on the poorly-defined notion of "corporate coherence". Thus, elite theory subsumes this aspect of institutional theory by providing a better specification of the relationship between elite turnover and policy incapacity.

To summarize so far, in network theoretic terms elite fragmentation is equivalent to a low level of cohesion. Three dimensions of cohesion and fragmentation are relations between party and policy elites, among incumbent policy elites and between elites active at different moments of time. The

latter dimension encompasses elite turnover (emphasized in institutional accounts) by noting that high turnover rates are often a reflection of underlying fragmentation generating elite conflict and high-level resignations.

2.2 Relations between economic and state elites

While relations among state elites have the most direct impact on policymaking capacity, state elites do not operate in isolation. State elites face pressure from other groups motivated to shape economic policies, especially economic elites. The relative power of economic and state elites is a longstanding debate in elite theory; classic perspectives include business power theories emphasizing the ability of capitalists to discipline the state (e.g. Block, 1977) and state autonomy theories (Skocpol, 1985). A full discussion is beyond the scope of this paper; here, I emphasize that the ability of economic elites to pressure or constrain state elites does not imply that state elites act coherently in the interests of economic elites. Instead, constraints and pressure in the absence of coherent collective action by economic elites erodes policymaking capacity without achieving economic elites' goals.

Whether or not economic elites effectively control state policies depends in part on their capacity for collective action. From the perspective of economic elites, macroeconomic stability is a public good; distinct elite sectors have diverging interests with respect to relevant policies (such as state spending, taxation and interest rates), creating coordination problems. Unresolved collective action problems impede economic elites' ability to pressure state elites to act coherently in their interests. Collective action capacity depends on a range of factors including the structure of relations among economic elites. Cohesive formal and informal networks create capacity for collective action and, in the absence of such networks, elites may pursue individualistic rather than collective benefits (Chu and Davis, 2016; Mizruchi, 2013). Further, encompassing associations bringing together diverse economic sectors provides a venue for the formation of collective goals and strategies, while the absence of such organizations fragments business (Schneider, 2004).

Collective action failure among economic elites does not imply greater state elite capacity. Capacity for coherent action is not zero-sum and disorganized action by economic elites can constrain state elites without giving economic elites effective leverage over state policies. For example, eco-

economic elites may have de facto veto power over some policies but still lack the ability to pro-actively design and implement coherent alternatives. Thus, a politically-mobilized but poorly-coordinated economic elite may remove policy options from the table without placing a coherent policy strategy back on the table.

A fragmented and poorly-organized economic elite paired with a cohesive and cooperative state elite might cede all power and initiative to the latter. But simultaneous fragmentation of both state and economic elites can create an elite stalemate in which these competing elites mutually constrain one another such that neither can achieve their objectives. Elite stalemates often have destabilizing consequences (Higley and Burton, 2006; Lachmann, 2002). The war of attrition model is essentially a theory of stalemate, though this model assumes that stalemates occur only between economic elites (or between elites and non-elites). However, stalemate between state and economic elites can also produce the delays predicted by this model. When economic elites can constrain the options of state elites but lack the ability to proactively set policy agendas, the outcome can be a prolonged irresolution of underlying economic problems. This situation of stalemate results from the simultaneous fragmentation of both economic and state elites.

Thus, generalized fragmentation among both state and economic elites produces a situation of elite stalemate. This stalemate compounds and interacts with processes generated within the state elite, undermining policymaking capacity in ways described in the next section. Elite theory therefore subsumes distributional conflict theories as one component of constraint on state elites' policy options within a broader pattern of elite competition and conflict.

2.3 Policymaking in fragmented elites

Elite fragmentation undermines policymaking capacity through five distinct mechanisms. First, elite fragmentation results in policy volatility: frequent, erratic, unpredictable and poorly planned policy changes. This is in part because competing elite network clusters pursuing independent goals and objectives do not share policy preferences and are therefore likely to often change course. Successive elites may be motivated to quickly unwind the policy legacies of their predecessors. Further, elite turnover often results in improvisation and poor planning, especially when difficult

economic circumstances drive turnover in the first place. Internal factionalism can also produce volatility when multiple groups of policy elites simultaneously influence policy outcomes. Policy volatility increases macroeconomic instability by causing market uncertainty.

Second, elite fragmentation creates incentives for short-termism and delay — the key element of the war of attrition model. Fragmentation tends to reduce policy elite tenures, and elites expecting short tenures have incentives to pursue short-run patches rather than more difficult long-term solutions. Because incumbent elites have few connections beyond their immediate circle of allies, they do not expect their successors to continue current policies (and may expect the opposite); therefore, there is limited motivation to attempt policies whose implementation timeline stretches out over years. Fragmented policy elites are not irredeemably locked into short-termism, as implied by some accounts of weak institutions, but the window of opportunity for ambitious policymaking tends to be short and concentrated early in policy elites’ tenures. Elites approaching the end of their tenures are often embattled and lack “political capital” to pursue ambitious policies. In this context, time horizons shrink and short-termism predominates.

Third, fragmentation focuses elite reputation formation on individuals and informal network clusters rather than organizations or the policy elite as a collective. The form in which external actors assess elite reputation matters for policy credibility, a factor stressed by many institutionalist theories (Bernhard et al., 2002; Leblang and Satyanath, 2006; Spiller and Tommasi, 2007). Credibility refers to market actors’ expectations regarding whether elites will implement announced policies in practice, including whether policy will change over relevant time horizons. Individualization (as opposed to collectivization) of reputation focuses market expectations on a single policy elites’ political position within the state. When elite turnover is a probabilistic signal of impending policy change, market actors monitor factional politics for signs of personnel changes. This creates the potential for self-fulfilling feedback effects (Merton, 1948): market actors adopt destabilizing economic strategies (e.g. capital flight) in anticipation of elite turnover and policy change, which then bring about turnover and the expected policy change. Reputational individualism is also vulnerable to credibility traps in which market actors do not trust incumbent elites, but the replacement of incumbents itself creates expectations of policy change. Because credibility

is important in economic policy and particularly in high-inflation situations, this makes economic outcomes sensitive to turnover and conflict among policy elites.

Fourth, elite fragmentation foments contradictory and incoherent policies due to turnover and low inter-organizational cohesion. Macroeconomic and financial policies involve complex interactions between policies under the jurisdiction of multiple organizations (for example, fiscal and monetary policy). Low inter-organizational cohesion increases the potential for poor coordination and self-defeating or mutually canceling policies. Elites in different organizations pursuing different goals and priorities who are unwilling to defer to one another may adopt policies at cross-purposes. Outright factionalism is an extreme version of this phenomenon. Elite turnover produces similar effects: large-scale rotation in elite networks results in improvisational and poorly-planned policy changes. Sequential and iterative policymaking episodes by distinct groups of policy elites with differing goals and priorities lead to incremental adjustments of prior policies that accumulate incoherence. Factionalism also undermines policy coherence when competition between factions leads to elite turnover resulting in improvised and iterative policy shifts.

Fifth, stalemate between economic and state elites also foments contradictory and incoherent policies. When economic elites fail to act collectively, policy elites are subject to multiple and contradictory pressures. Pressure from economic elites removes policy options from the table, leaving policy elites with few good choices. These constraints compound the effects of short-termism, incremental adjustment and competition among policy elites. Policy elites working with a limited toolkit under severe external pressures are more likely to adopt sub-optimal and incoherent policies. These policies may themselves amplify distributional conflict, creating new sources of pressure from economic elites.

In summary, generalized elite fragmentation is a situation in which divisions among competing elite individuals and groups affect both economic and state elites. An elite stalemate between economic and state elites results from fragmentation within both key elite sectors. Elite fragmentation undermines policymaking capacity through four distinct mechanisms: policy volatility, short-termism, reputational and credibility problems, and contradictory and incoherent policies. Volatile, poorly-designed and incoherent policies in turn foment instability, including the extreme

instability of hyperinflation.

3 Elite relations in Argentina

3.1 Fragmentation of state elites

Argentine state elites are fragmented along the three dimensions discussed above. First, policy elites are not embedded in cohesive networks connecting them to party elites. Neither major political party active in the 1980s had a substantial internal corps of policy elites. Reasons for this fragmentation included limited governing experience due to frequent interruptions of democratic governance under military regimes and party factionalism. For example, the Radical Civic Union (UCR or Radical) party in power at the outset of hyperinflation had last governed between 1958 and 1966, during which it also experienced a factional split. By the 1980s, the few remaining policy elites associated with the party were ill-equipped for governance. After achieving poor economic outcomes during his first year in office, President Raúl Alfonsín (1983–1989) delegated policy authority to a network of independent economists with few ties to Radical party elites.⁵ Similarly, the Justicialist (Peronist) party was largely proscribed after 1955 and governed for only three years in the 1970s, ending in a military coup. Following Carlos Menem’s 1989 electoral victory, the party had an electoral machine but effectively no governing apparatus (Levitsky, 2003). As a result, Menem primarily recruited elites from outside the party, many of whom had openly not even voted for him.⁶

Second, synchronic cohesion (relations between incumbent elites) and especially inter-organizational cohesion was low. Van Gunten (2015) compared the network structure of Argentine and Mexican policy elites, showing that elite cohesion is higher in Mexico than in Argentina; as defined above, fragmentation is equivalent to low cohesion. The Argentine policy elite consists of many discrete elite clusters of varying size and degrees of internal cohesion but persistently few connections between clusters. The vernacular term “economic team” describes these informal clusters and generally refers to a cluster of officials loyal to the Economy Minister. In practice, “teams” were relatively isolated entities often disconnected from other elites. At times, the Economy Minister’s network

of allies was limited to a few officials, with other state organizations controlled by competing networks. In other words, inter-organizational cohesion was variable and often low. Factionalism was acute during the early Menem administration; in this period, a variety of elite clusters competed for influence. Senior elites leading these organizations lacked prior connections and understood themselves as competitors, leading to elite conflict.⁷ At this time, the “economic team” was a small network competing with other elite factions within the state. As the Minister later wryly observed, “With time I realized that you can’t be Minister of Economy without the support of 50 or 60 people you can trust...and unfortunately there were only three or four of us.”⁸

Third, policy elites fragmented over time. This fragmented structure partly reflects the lack of network connections between successive elite clusters active over time. Economic policy during hyperinflation was under the control of a rapid succession of elite network clusters; between January 1989 and January 1991, there were six Economy Ministers and six Central Bank presidents (see Table 1). This brief period substantially accounts for the high turnover and short tenures of economic policy elites observed by institutionalists (Dornbusch & de Pablo, 1989). Crucially, the turnover involved not just replacement of senior elites, but entire swathes of the policy elite as subordinates departed along with their superiors. In the absence of a robust bureaucratic or party corps, turnover entailed replacing large numbers of senior officials with entirely new networks of officials with no established relations to their predecessors. High turnover was also a reflection of elite fragmentation and, as shown in Table 1, conflict with other elites often resulted in high-level resignations.

Table 1: Tenure length and reason for departure of policy elites

Position	Elite	Dates	Tenure	Reason for departure
Economy Minister	Sourrouille	Feb. 1985-March 1989	4 years	Resignation under pressure from dissenting party elites and economic instability
Economy Minister	Pugliese	April-May 1989	6 weeks	Resignation due to outcome of Presidential election and economic instability
Economy Minister	Rodriguez	May-July 1989	6 weeks	End of presidential mandate
Economy Minister	Roig	July 1989	1 week	Deceased
Economy Minister	Rapanelli	July-Dec. 1989	5 months	Resignation in the context of conflict within policy elites and economic instability
Economy Minister	Gonzalez	Dec. 1989-Feb. 1991	14 months	Change of position in cabinet reshuffle
Central President	Machinea	July 1986-March 1989	3 years	Collective resignation under pressure from dissenting party elites and economic instability
Central President	Garcia Vazquez	April-July 1989	3 months	End of presidential mandate
Central President	Gonzalez Fraga	July-November 1989	5 months	Resignation in the context of conflict within policy elites and economic instability
Central President	Ianella	Dec. 1989	3 weeks	Resignation in the context of conflict within policy elites and economic instability
Central President	Rossi	Dec. 1989-Jan 1990	1 month	Resignation in the context of conflict within policy elites and economic instability
Central President	Folcini	Jan - March 1990	2 months	Resignation in the context of conflict within policy elites and economic instability
Central President	Gonzalez Fraga	April 1990-January 1991	10 months	Resigned

3.2 Stalemate: Economic and state elites

Like state elites, Argentine economic elites were fragmented, undermining their capacity for collective action. Two important elite economic sectors during hyperinflation were landholding agrarian exporters and wealth holders.⁹ Agrarian exporters were historically “the” Argentine elite, dominating the state in the early twentieth century and continuing to hold substantial political weight. The association of large agrarian landholders, the Argentine Rural Society, was the most consistently organized and vocal representative of economic elites (Heredia, 2003; Schneider, 2004). In contrast, wealth holders were a heterogeneous and diffuse sector consisting of individuals and organizations holding liquid assets.¹⁰ Wealth holders lacked effective political representation; however, they held a potent but blunt instrument of structural power: capital flight. Agrarian elites, wealth holders and other economic sectors (e.g. industrialists) pursued competing, and often incompatible, goals during the crisis.

Collective action failure among elites reflected in part the structure of relations among economic elites. Corporate board interlock networks are highly fragmented (Lluch and Salvaj, 2014), similar to the late-twentieth century corporate networks in the United States (Chu and Davis, 2016). Unlike other Latin American countries, Argentina did not have a high-level association in which economic elites could discuss policy goals and strategies (Schneider, 2004). Agriculture, industry and finance each had separate associations pursuing particularistic sectoral demands, but there was no organizational structure in which economic elites could coordinate an approach to macroeconomic stability. Sectors were often internally fragmented: for example, conflict between domestically-owned and international banks resulted in an organizational rift in the financial sector in the 1990s, presaged by conflicts discussed below.

Given this fragmentation, the constraints imposed by economic elites were disorganized rather than coherent. Agrarian elites pressured the state through lobbying and (limited) direct access to state positions, giving these elites an effective veto over certain policies, but as shown below, they had limited ability to proactively design coherent policy. The limited capacity of economic elites to govern directly is exemplified by an exceptional period of direct access discussed below: at the beginning of his government President Menem directly delegated control over economic policy to

economic elites, but this period lasted only a few months and ended in the return of hyperinflation. Economic elites did exercise substantial structural power; however, structural power was a blunt instrument that constrained the options of state elites without providing a proactive policy agenda. Economic and state elites were locked in a stalemate in which the former could constrain the options of policy elites but lacked capacity for collective action; state elites could impose substantial costs on economic elites but could not control economic elites' destabilizing investment strategies. This stalemate was part of the broader pattern of generalized elite fragmentation.

4 The macroeconomics of inflation in Argentina

Argentine hyperinflation was the culmination of chronic high inflation spanning decades: annual inflation averaged above 20 per cent from 1950 to 1970 and over 100 per cent during the 1970s, reaching near-hyperinflationary levels in 1976.¹¹ The 1983–1989 government of UCR President Raul Alfonsín struggled to control inflation, and achieved only moderate success mid-decade. However, by late-1988 the macroeconomic situation was extremely fragile. This fragile situation exploded into hyperinflation in the first half of 1989.

Argentina experienced two distinct waves of hyperinflation during 1989–1990 and this pattern is critical to understanding the elite politics of the crisis. Figure 1 shows the monthly rate of inflation and exchange rate depreciation from 1989 to 1991. The first wave of hyperinflation began with accelerating currency depreciation in February 1989 and passed the 50 per cent threshold — a conventional definition of hyperinflation (Cagan, 1956) — in May. Following the victory of Peronist Carlos Menem in the May 1989 elections, Alfonsín brought forward the transfer of presidential power originally scheduled for December. The political transition was followed by a “honeymoon” period of comparatively moderate inflation lasting several months. However, currency depreciation beginning in the final months of 1989 developed into a second wave in early 1990. Inflation fell to comparatively moderate (though still double-digit) levels by mid-1990, before finally stabilizing in 1991.

The two-wave pattern establishes key facts about the crisis and its resolution. First, because hyperinflation occurred during governments of the two main political parties, any explanation must

Figure 1: Inflation and exchange rate depreciation, 1989-1991



apply equally to both parties. Second, contemporary observers attributed hyperinflation to pre-electoral political uncertainty and fear of Menem’s “populist” rhetoric during the elections (Machinea, 1990). The main problems with this explanation are that inflation stabilized when Menem took office and then returned when there was no equivalent source of political uncertainty. Third, subsequent accounts attribute the end of the crisis to the adoption of the 1991 Convertibility Law, which fixed the Argentine currency to the dollar at a one-to-one rate (Levitsky and Murillo, 2005; Weyland, 2004). However, while inflation remained high by international standards through early 1991, hyperinflation per se ended a year before the law’s passage.

As noted in the introduction, a standard explanation for hyperinflation is that extreme political events such as revolution and regime change disrupt normal mechanisms of state finance; states unable to control spending or raise tax revenue resort to unrestrained printing of paper money (Fischer et al., 2002). This account provides both a macroeconomic mechanism and an underlying political cause. The macroeconomic mechanism is uncontrolled money creation to pay for large fiscal deficits driven by exceptional demands on expenditure or the failure of revenue collection. The underlying cause of these deficits is an extreme political event.

However, no extreme political event equivalent to revolution or regime change occurred in Argentina in 1989.¹² Similarly, there were two main problems with the conventional fiscal mechanism. First, the central government deficit prior to hyperinflation was substantial but not large enough to account for hyperinflation as opposed to merely high inflation (Beckerman, 1995).¹³ Fiscal deficits were necessary but not sufficient to explain hyperinflation. Second, the conventional account ignores the modern macroeconomic literature on hyperinflation, which emphasizes the causal role of exchange rate markets (Fischer et. al., 2002, pp. 850–852; Dornbusch, 1985). According to these accounts, a rapidly depreciating exchange rate — that is, a currency run — is the proximate cause of hyperinflation.¹⁴ This is consistent with the evidence in Figure 1 that shows currency depreciation preceding rising inflation in both waves.¹⁵

These stylized facts are inconsistent with the fiscalist assumptions of the war of attrition model. An additional problem is that the war of attrition model postulates crises end when one side of a distributional conflict concedes and bears the costs of eliminating the fiscal deficit. However, the

Argentine hyperinflation did not end with a qualitative change in spending, revenue or both. As shown in Figure 2, the Argentine state did achieve a sustained fiscal surplus beginning in 1991, but it did so because both revenue and spending increased in real terms as the economy recovered following the prolonged crisis. This is consistent with modern macroeconomists' recognition of the endogeneity of fiscal deficits in high inflation situations; in other words, causality runs from inflation to the deficit as well as vice versa (Fischer et. al., 2002, pp. 839).¹⁶ Because spending increased in real terms following the crisis, the war of attrition model requires a substantial increase in revenue from new sources. Revenue did increase as a percentage of GDP from 1990 but resulted from the recovery of existing revenue sources rather than a major change in the structure of taxation (figure 3).¹⁷ Thus, there is little evidence that a qualitative change in fiscal policy preceded the end of the crisis.

In general terms the macroeconomic mechanisms that produced hyperinflation were financial rather than narrowly fiscal. The Argentine state was indebted to the point of insolvency; external sovereign debt was a crushing burden but not the crucial factor underlying hyperinflation. Rather, most contemporary and informed macroeconomic accounts of the Argentine hyperinflation focus on the so-called quasi-fiscal deficit (Almansi and Rodriguez, 1989; Beckerman, 1995; Graziano, 1990). The Argentine state — more specifically, the Argentine Central Bank — was heavily indebted at high interest rates to the domestic banking system. The flow of interest payments on this debt constituted money creation, a source of inflation. The existence of this deficit had self-defeating effects: high Central Bank interest rates intended to control inflation but instead paradoxically resulted in automatic expansion of the money supply. The Central Bank tried to absorb this liquidity to prevent inflation, but available means of doing so inevitably increased its own debt.

Wealth holders' bank deposits were a counterpart of this Central Bank debt. In other words, wealth holders "lent" funds to banks (in balance sheet terms, deposits are bank liabilities or debt), which in turn lent these to the Central Bank. Following decades of high inflation, most wealth holders' assets were short-term time deposits (similar to certificates of deposit in the US) earning high interest rates. Bearing in mind that most modern money is bank money (Ingham, 2005), this meant that most Argentine money paid interest. Banks could only pay these high interest rates by

Figure 2: Fiscal balance (inflation-adjusted constant pesos), 1976-1995

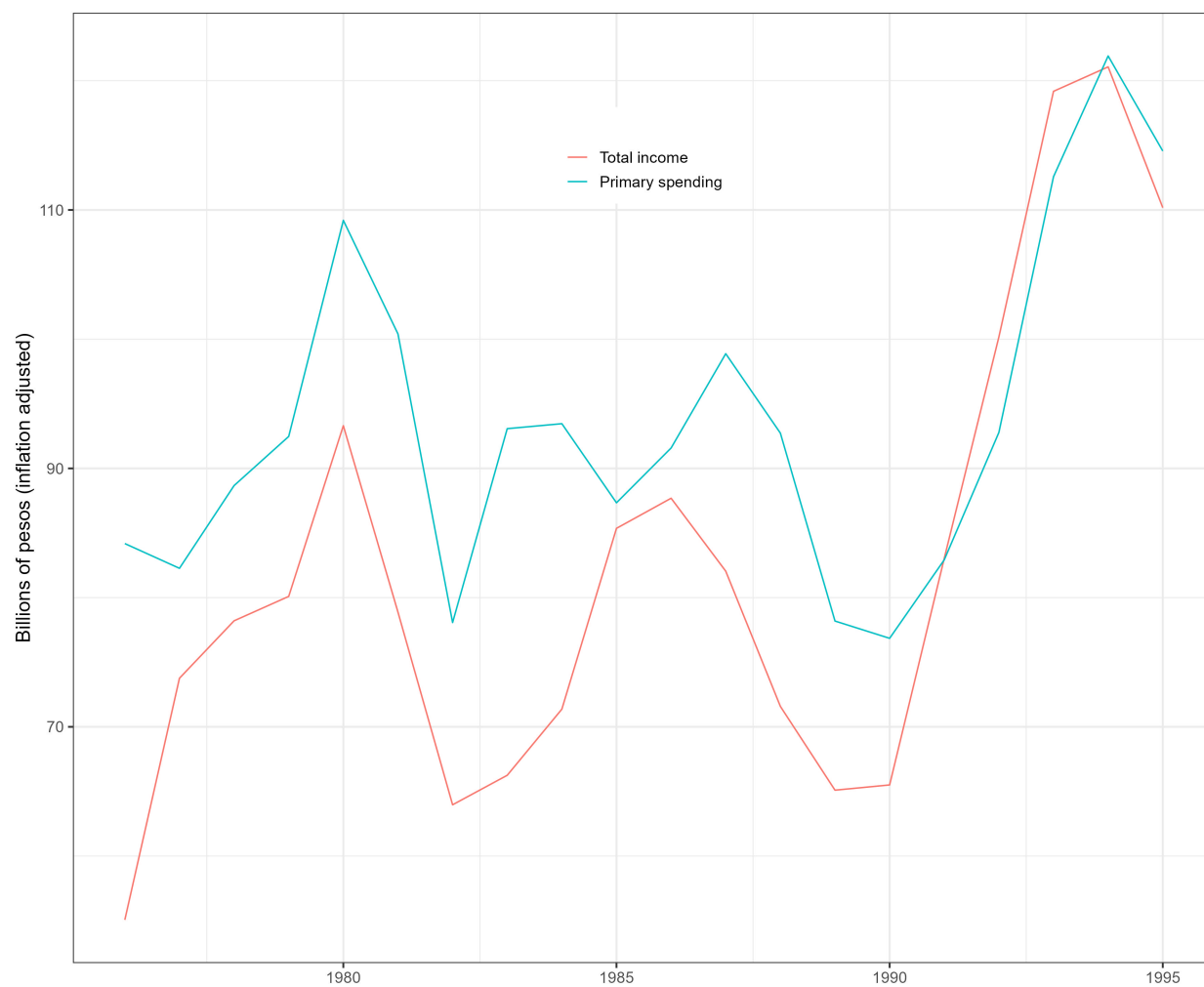
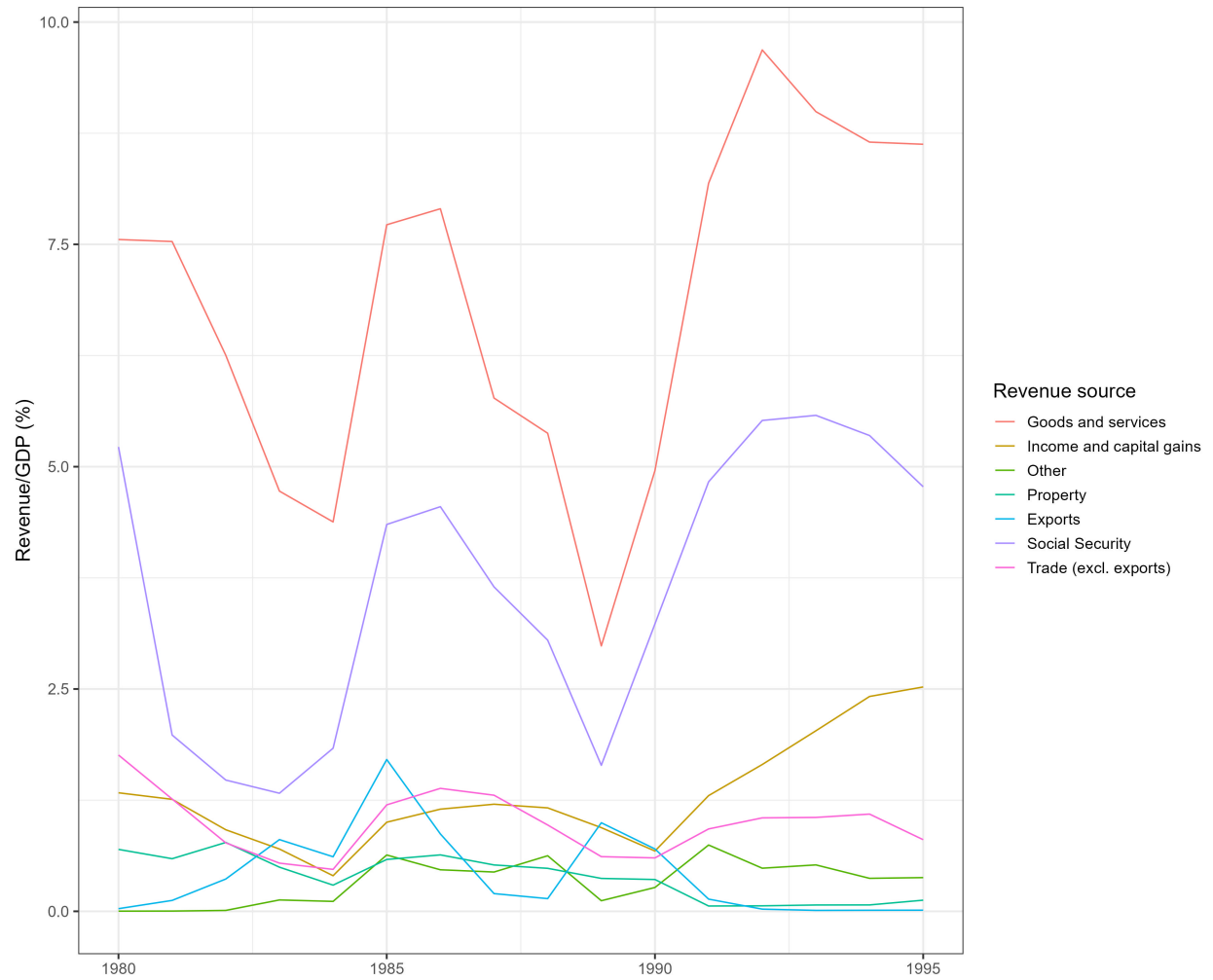


Figure 3: State revenue sources (as percentage of GDP), 1980-1995



receiving the corresponding flow of interest payments from the Central Bank. This is the financial context that rendered the Argentine Central Bank insolvent.

To clarify this macroeconomic mechanism, it is helpful to anticipate a key turning point in the conclusion of the crisis. The solution to state insolvency is generally default and rescheduling of debt. Hyperinflation ended — though not immediately — when the Argentine Central Bank effectively defaulted on its debt in January 1990. With the so-called Plan Bonex, the Argentine state repudiated the Central Bank’s debt to the banking system and forcibly converted savings deposits into long-term, dollar-denominated bonds known as Bonex (Beckerman, 1995; Reinhart and Rogoff, 2009). Taken together, these two measures eliminated the Central Bank deficit by effectively partially expropriating the assets of wealth holders. In a sense this amounted to default on money itself. While the state nominally recognized its liabilities at face value in the form of Bonex bonds, rescheduling short-term savings deposits to a ten-year horizon imposed substantial losses on wealth holders in the short run. Depositors needing immediate access to their funds had to sell bonds at a discount as high as 70 per cent (Beckerman, 1995, p. 678). This policy played a key role in bringing the hyperinflation crisis to an end by effectively eliminating the Central Bank deficit — though, as shown below, in the short run an incoherent roll-out of the policy contributed to the second wave of hyperinflation.

Wealth holders’ assets were also linked to the second macroeconomic mechanism driving hyperinflation, the linkage between the US dollar market and the inflation rate. Prices were closely related to the dollar market because the daily dollar exchange rate was the main indicator available to producers and commercial firms setting prices within a context of extreme uncertainty. Depreciation of the dollar exchange rate drove prices upwards, and currency depreciation was driven by capital flight as panicked wealth holders sought to protect the value of their assets. Currency runs involve complex self-fulfilling dynamics: regardless of wealth holders’ own beliefs, if they believe that other wealth holders expect the currency to fall, they have an incentive to convert their assets immediately (Morris and Shin, 1998). These currency runs were the proximate cause of hyperinflation, while the expansion of liquidity through extremely high interest rates (ultimately paid by the Central Bank deficit) provided necessary fuel for the fire.

This macroeconomic context clarifies the distributional conflict at the heart of hyperinflation. In a context of chronic inflation, wealth holders tried to maintain the real value of their assets either by holding high interest rate time deposits, or by converting assets to dollars. When wealth holders feared imminent currency depreciation, their incentive to exchange local currency for dollars magnified. Agrarian exporters sat on the other side of the foreign exchange market because export revenues were the main source of dollars. Both sides sought to minimize losses; while wealth holders benefited from a lower exchange rate (that is, a cheaper dollar), agrarian exporters benefited from a higher exchange rate because of their dollar revenues. In this sense hyperinflation was the result of these competing economic strategies; as shown below, however, the state itself was an active participant in this distributional conflict.

5 Origins and continuity of the central bank deficit

As the previous section shows, insolvency of the Argentine Central Bank was a primary financial cause of hyperinflation. The first question is therefore: why was Argentine state indebted to the banking system, creating the “quasi-fiscal” deficit? The deficit resulted from an incoherent and contradictory organizational structure that accumulated over the course of a decade. In the fragmented Argentine policy elite, a succession of officials pursuing incompatible goals tinkered with policies left in place by their predecessors, creating a contradictory structure. These iterative policymaking cycles allowed contradictions to accumulate, becoming increasingly difficult to unwind. The short time horizons characteristic of a fragmented policy elite generated strong incentives to postpone difficult decisions. By the late 1980s, the situation was intractable; it took two waves of hyperinflation to finally force a solution.

Beginning in the 1970s, the Argentine Central Bank paid interest on bank reserves (financial system deposits in the Central Bank required for regulatory and monetary policy purposes). In balance sheet terms, these reserves are liabilities (debts) of the Central Bank. This unusual policy originated in conflict over the financial system. The 1973–1976 Peronist government partially nationalized the banking system by instituting a policy of 100 per cent reserve requirements — that is, banks had to forward all deposits to the Central Bank. After seizing power in 1976, military

rulers delegated authority to market-oriented policy elites who rapidly reversed nationalization and liberalized the financial system. Reversing nationalization was difficult because uniform reduction of reserve requirements (which is what the measures technically required) had unequal consequences across segments of the banking system.¹⁸ This constrained the options of policy elites, who adopted an incremental reform intended as a temporary, transitional measure: an organizational structure known as the “monetary regulation account” into which banks paid in fees and earned interest, and was designed to net out across the financial sector (Beckerman, 1995).

This attempt to liberalize the financialization system resulted in a major banking crisis within a few years (Baliño, 1987). Combined with factional conflict in the military junta, this economic instability and led to disruptive policy elite turnover: in the chaotic final years of the military regime, multiple informal groups cycled rapidly through the main economic policy organizations. In 1982, Domingo Cavallo (later a key elite during hyperinflation) took over the Central Bank and pursued policy goals that differed substantially from the liberalizing objective of previous elites.¹⁹ Cavallo seized the window of opportunity early in his tenure and rapidly adopted a battery of reforms; he then resigned after only 53 days in office due to further factional conflict in the military. Replacement elites started another incremental cycle, disrupting measures left in place by Cavallo. These iterative policymaking processes in a fragmented elite pursuing disparate goals rendered Central Bank policy incoherent; one outcome was the “temporary” suspension of fee payments into the monetary regulation account while continuing to pay out interest, generating a deficit.²⁰ This was a major origin of the Central Bank’s “quasi-fiscal” deficit.

As a result of these episodes, the Alfonsín government inherited unsustainable organizational structures in 1983. Factional struggles between the Central Bank and the Economy Ministry during the early years of the democratic government delayed an effective response.²¹ In 1986, a single cohesive “economic team” led by Economy Minister Juan Sourrouille centralized control over economic policy, ending internal factional conflicts; however, by this time the window of opportunity for ambitious policymaking had closed. Early relative success gave way to rising inflation and prolonged economic malaise. Given the reputational individualism characteristic of a fragmented elite, poor performance undermined the Sourrouille team’s reputation among economic and party

elites. Senior policy elites became convinced that they personally lacked credibility and offered their resignations in favor of others with less tarnished reputations.²² However, facing the limited supply of competent and politically acceptable elites, the President refused.²³ Elites were locked in a credibility trap.

In this context, policy elites' time horizons shortened, and they postponed major reforms and instead resorted to incremental muddling through. Policy elites recognized the Central Bank deficit as a problem but adopted only incremental reforms which did not address the fundamental problem.²⁴ The dilemma was genuinely challenging (Beckerman, 1995). Accumulation of Central Bank debt made these contradictory structures difficult to unwind: the debt had to be paid but paying the debt balance with banks entailed money creation and therefore further inflation. Postponing resolution of the debt issue allowed elites to moderate inflation in the present at the cost of allowing incoherent organizational structures to persist. Addressing the deficit required a complex financial reform which would inevitably impose large but uneven costs on economic elites. The difficulty is evident from the solution eventually adopted in 1990 (the plan Bonex), which entailed a deeply unpopular default and expropriation of wealth holders. This policy was only adopted out of desperation once a second wave of hyperinflation was underway. Addressing this problem earlier would have been challenging even in a cohesive elite; in a fragmented policy elite, the incentive to postpone difficult policy decisions was overwhelming.

To summarize, the organizational structures creating the Central Bank deficit emerged from iterative and sequential policymaking cycles in a fragmented policy elite. These episodes clarify the relationship between elite turnover and policy capacity that has been emphasized in institutionalist accounts. Elite turnover was one manifestation of patterns of elite competition in a fragmented elite; frequent changes in state personnel undermined capacity to deliver coherent policies because repeated tinkering by successive elites generated accumulating incoherence, while short-termism inhibited genuine reforms needed to address deep structural problems. An institutionalist explanation based on the notion of "corporate coherence" either treats elites as more passive (lacking in shared norms to motivate action) or as pursuing strictly individualistic motives through corruption. But these assumptions are a poor fit for the repeated active policymaking cycles generating contra-

dictory policies. Elite fragmentation, rather than weak institutions, provides a better explanation for the persistence of policy incoherence.

6 The first wave: January-July 1989

6.1 Policy incoherence in the Plan Primavera

In late 1988, policy elites launched a final attempt to slow inflation in advance of the upcoming Presidential elections. This set of policies, known as the “Plan Primavera” or spring plan, was a contradictory and incoherent mix that created catastrophic downside risks in the event of failure. Alongside a price agreement with industrial and commercial elites and a battery of other measures, the plan featured an unconventional mechanism for extracting revenue from agrarian exporters. For reasons explained below, this amplified the risk of an explosive currency run. These risks were later realized when the plan collapsed in early 1989, setting in motion the first wave of hyperinflation.

The contradictions of the Plan Primavera partly reflected a deepening stalemate between the state and economic elites. The Radical party faced opposition from organized labor (a key Peronist constituency) and thus sought support from economic elites. However, the latter were increasingly irritated by poor economic performance, and agrarian elites were increasingly vocal in the late 1980s.²⁵ In an attempt to shore up political support following electoral losses, Alfonsín made concessions to economic elites, including agrarian exporters. Most significantly, he agreed to agrarian elites’ longstanding demand for elimination of export taxes on most agricultural commodities. The removal of export taxes constrained the options of policy elites attempting to balance the state budget.

These stylized facts appear consistent with the war of attrition model: on this interpretation, agrarian elites’ power to resist taxation delayed elimination of the fiscal deficit. However, the importance of this distributional conflict was not primarily its direct effect on the state budget because, as shown in Figure 3, export taxes were a relatively minor revenue source.²⁶ Furthermore, policy elites did not capitulate to economic elites’ demands; instead, they worked around them by introducing a mechanism to capture agricultural export revenue through the foreign exchange

market. The Plan Primavera required agrarian exporters to sell dollars to the Central Bank at a lower exchange rate than that paid by dollar buyers — notably, wealth holders. In other words, the Central Bank bought cheap dollars from agricultural exporters and sold them at a higher cost to wealth holders, retaining the difference as state revenue. This was in effect an implicit tax on exports expected to generate a significant share of the projected deficit due to foregone taxes.²⁷

In the war of attrition model, distributional conflict is exogenous to state action. In this case, however, state elites created a new axis of latent distributional conflict between agrarian elites and wealth holders by segmenting the exchange rate market. The main axis of overt conflict was not between political elites representing distinct economic elites, but rather between agrarian elites and the state. Policy elites' attempt to work around the constraints imposed by economic elites had the unintended consequence of increasing, rather than reducing, conflict with economic elites.²⁸ Agrarian elites complained bitterly about the “discriminatory” treatment and jeered President Alfonsín at the annual fair of the Argentine Rural Society, a symbolic event representing agrarian exporters. Thus, while distributional conflicts were undoubtedly central to elite conflict, conflict between state and economic elites (rather than between different economic sectors, as posited by the war of attrition model) were at the core of this conflict. Moreover, state policies shaped distributional conflict rather than merely reflecting it.

The primary impact of this elite stalemate was to undermine policy coherence by removing state elites' policy options in an already difficult situation (rather than any direct fiscal impact, as discussed above). These constraints interacted with the incentives resulting from the fragmented character of the policy elite. As noted in the previous section, by late 1988, policy elites were locked into a credibility trap and focused on very short time horizons. Policy elites correctly believed that their own credibility was severely limited due to the reputational damage they had suffered from earlier perceived policy failures, and they were now self-consciously “muddling through” on the assumption that their window of opportunity for major policy initiatives had closed.²⁹ Policy elites' only goal was to reach the scheduled elections with a modicum of stability. Given the constraints imposed by economic elites and their own short time horizons, policy elites felt they had few options and adopted policies they themselves recognized as risky and suboptimal.

This combination of external constraint and short-termism resulted in a set of economic policies which was an incoherent and risky gamble. Maintaining the tiered exchange rate system to extract revenue from agrarian elites required extremely high interest rates to incentivize wealth holders to keep assets in domestic currency, rather than seek safety in the dollar. But, because the Argentine Central Bank ultimately paid high interest rates by creating currency (through the Central Bank deficit), this defeated the policy's goal of controlling inflation. Policy elites sought to absorb this liquidity, but the available tools meant increasing the Central Banks' own debt — and therefore further future interest payments. Reliance on the foreign exchange rate market to collect revenue was thus contradictory and amplified risks in the case of failure.

The incoherent design of the “Plan Primavera” illustrates the interaction of stalemate between state and economic elites and the fragmentation of the policy elite. Economic elites had sufficient power to obtain important policy concessions, but policy elites still retained sufficient autonomy to impose a functionally equivalent means of revenue extraction. Combined with the short time horizons characteristic of a fragmented elite, the result was an incoherent set of policies that ultimately failed.

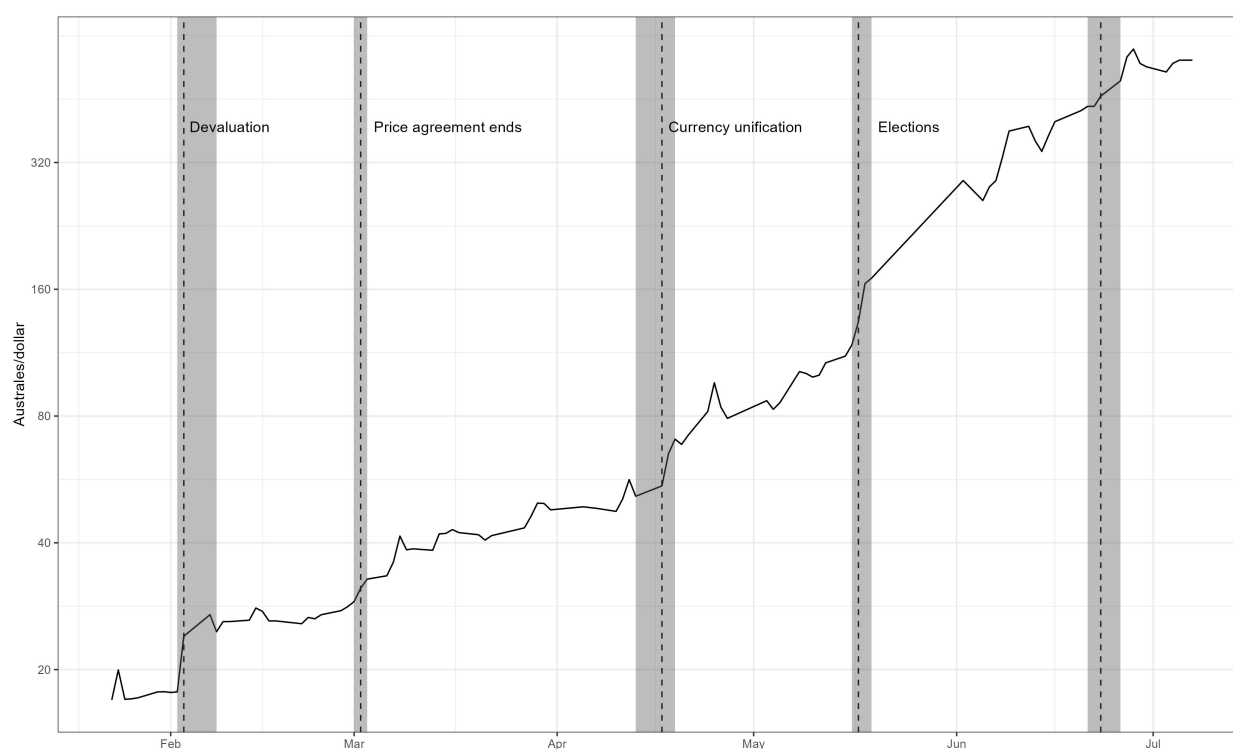
6.2 Towards hyperinflation: February-April 1989

As noted above, the proximate cause of hyperinflation was a currency run resulting from wealth holder's collective conversion of local currency assets to dollars. The currency run resulted from wealth holders lack of confidence that policies announced in the Plan Primavera would continue. This credibility deficit reflected wealth holders' understanding of policymaking processes in the fragmented policy elite, exacerbated by volatile and incoherent policymaking.

Up until February 1989, wealth holders maintained substantial local currency balances because the Central Bank's extremely high real interest rates made these balances profitable (Beckerman, 1995). Wealth holders' strategies depended on their expectations about the relative returns on high-interest local currency holdings and dollar assets; these expectations rested in turn on the likelihood that current policies would continue.³⁰ In early February, these expectations changed when the Central Bank abruptly announced its withdrawal from the dollar market, leading to a

sharp currency devaluation; more than any other moment, this decision marks the beginning of the hyperinflation crisis. Figure 4 reports the US dollar exchange rate paid by wealth holders during the first wave and identifies breakpoints marking the acceleration of currency depreciation.³¹ The first breakpoint coincides with the February devaluation. Nevertheless, the crisis did not immediately spiral out of control and the exchange rate stabilized during February. The currency run accelerated again following the collapse of the Plan Primavera price agreement in early March (the second breakpoint labeled in Figure 4). By mid-March, a sustained currency run was underway.

Figure 4: US dollar exchange rate during the first hyperinflation



The policy elite's credibility deficit helps account for the exchange rate market's extreme vulnerability to a currency run. As argued above, a credibility trap is a situation in which incumbent elites are reputationally damaged, undermining market confidence, but the replacement of incumbents itself creates uncertainty. This uncertainty gave wealth holders an overwhelming incentive to seek safety in the dollar. The February devaluation and later collapse of the price agreement were an additional blow to the reputations and credibility of incumbent policy elites. Informed

observers had good reasons to expect elite turnover, and new elites in turn implied new policies with unknown implications. Consistent with this, rumors of impending elite resignations emerged following the devaluation and grew after the collapse of the price agreement.³² Both policy elites and wealth holders explicitly understood the Plan Primavera as incumbent elites' "final attempt" to provide stability in advance of the elections.³³ The collapse of this plan created radical uncertainty because wealth holders understood that incumbent elites had no further cards to play, but elite turnover entailed new uncertainties about future policy. Observers in March 1989 did not yet know the outcome of elections and could not know that the transfer of presidential authority would be accelerated, so the horizon of uncertainty stretched out for nine months. Given this extended uncertainty, wealth holders collectively decided to convert local currency assets to dollars.

This credibility trap acquired a self-fulfilling dimension due to elite fragmentation, vis-a-vis party elites. Incumbent policy elites were relative outsiders not embedded in cohesive networks linking them to party elites and their relationship to party elites was almost entirely based on their connection to an increasingly unpopular president. This rendered policy elites vulnerable to challenges by party elites. A vocal minority of dissenting party elites was strongly critical of Economy Minister Juan Sourrouille and his allies, and the Radical party's presidential candidate turned on Sourrouille, ultimately openly calling for his resignation. Facing this internal conflict, Sourrouille finally resigned. This high-level turnover ricocheted down the state apparatus as subordinates followed suit. The result was that during an accelerating financial crisis, the upper echelons of state organizations were suddenly empty, with new and untested elites taking their places. As noted above, the UCR had a limited internal corps of policy elites, and Alfonsín had few options to replace senior leaders. Seeking to quell party conflict, he appointed a party elite whose previous economic policy experience in the 1960s left him unprepared to govern and overwhelmed by the ballooning crisis.³⁴

Through a feedback process, poor economic performance increased elite conflict and elite turnover; the turnover resulted in improvisation and volatility, which in turn exacerbated instability. New elites struggled to identify policies with a plausible chance of success and made a series of abrupt policy changes which amplified uncertainty in the exchange rate market. The capstone of this

improvisational decision-making was a major policy change: “unification and liberation” of the exchange rate, that is, the abandonment of the exchange rate to market forces and the elimination of the tiered exchange rate regime introduced in the Plan Primavera. Freeing the exchange rate during a currency run was incoherent: there was no plausible way in which this would contribute to policy elites’ stated goal of lowering inflation. By eliminating the tiered exchange rate, policy elites hoped to reduce conflict with agrarian exporters.³⁵ However, they simultaneously reinstated export taxes on agricultural commodities, making the policies functionally equivalent. The attempt to reduce conflict with economic elites backfired again: agrarian elites continued to militate against the new regime.³⁶

While failing to resolve distributional conflict with agrarian elites, these volatile policy changes amplified wealth holders’ uncertainty, adding fuel to the currency run. Because the policy change made further currency depreciation more likely, wealth holders had a strong incentive to convert funds to dollars immediately. Rumors about the policy change circulated at least a week before formal announcements, creating uncertainty that amplified the incentive towards capital flight.³⁷ Policy elites and President Alfonsín repeatedly denied further forthcoming policy changes, an indication of widespread uncertainty and speculation;³⁸ these high-level denials only reinforced the rumors. As shown in the breakpoint analysis reported in Figure 4, the mid-April policy was a significant turning point in the crisis. Whereas the exchange rate doubled approximately every 30 days in the six weeks before this decision, the doubling time fell to eight days following the decision to “free” the exchange rate. Within weeks, the rate of inflation passed the 50 per cent threshold: hyperinflation had begun.

7 The second wave: November 1989-March 1990

On May 14, 1989, Peronist Carlos Menem won the presidential elections in the midst of hyperinflation. The crisis deepened and, amid daily price increases and widespread scarcity of basic goods, looting spread around the country. Following failed negotiations to accelerate the transfer of presidential authority, Alfonsín unilaterally resigned. Hyperinflation reached a crescendo as Menem took office — prices tripled in two days surrounding the presidential transition in July³⁹ — and

then subsided, falling below 10 per cent monthly by September. After three months of accelerating hyperinflation, the currency run ended suddenly and unexpectedly, permitting a moderation of inflation.

7.1 The limited capacity of economic elites

President Menem's initial strategy after taking office was to delegate control over economic policy to economic elites associated with Bunge y Born, a corporation epitomizing the historic agrarian elite.⁴⁰ This was an exceptional moment as Argentine economic elites rarely enjoyed direct high-level control over economic policy. The war of attrition model predicts that such a shift should consolidate political power, ending distributional conflict by forcing the opposing party to capitulate. However, this did not occur: the experiment in delegation to economic elites lasted only five months and ended in a second wave of hyperinflation.

In reality, economic elites were no more capable of implementing consistent and coherent economic policies than other policy elites. Direct delegation to economic elites did not fundamentally change the dynamics of policymaking within the fragmented elite; economic elites were simply the latest informal elite network competing for control over the state. Despite a rhetoric of alliance with economic elites, in reality the Bunge y Born "economic team" was a handful of former managers who did not represent agrarian elites more broadly.⁴¹ This network competed for influence with a heterogeneous set of other elites occupying positions in the early Menem administration, giving them only partial control over economic policy. Most significantly, the Bunge y Born network did not control the Central Bank, which had been delegated to prominent financial adviser Javier González Fraga, who was determined to assert his independence from the Economy Ministry and pursue his own policy agenda.⁴² As a result, the early Menem administration was factionalized, and inter-organizational cohesion was minimal.

After a few months, Menem's "honeymoon" period ended when the dollar began to drift upwards, stimulating fears of a new currency run. Deteriorating macroeconomic conditions aggravated the underlying factional competition among policy elites, especially between the Economy Ministry and Central Bank. Senior officials resigned over policy disputes between the organizations,

heightening the visibility of elite conflict.⁴³ Latent tension degenerated into outright conflict, culminating in the Central Bank's president resignation in response to open pressure from the Economy Minister.⁴⁴ Open factional conflict focused wealth holders' attention on the political fortunes of individual policy elites, encouraging widespread speculation about elite resignations and consequent policy changes.⁴⁵ Elite conflict thus fueled uncertainty and amplified wealth holders' incentive to convert assets to dollars.

In December, self-fulfilling dynamics resembling the first hyperinflationary wave developed. Uncertainty about impending policy changes intensified the currency run, and bad economic news exacerbated elite conflict, eventually leading to elite turnover and producing policy change. As the crisis intensified, the Bunge y Born "team" resigned in response to bad economic news and internal factional conflict. As in April, replacing elites in the middle of an accelerating crisis led to improvised and incoherent policies. Given the limited supply of competent policy elites, Menem appointed an inexperienced political ally as Economy Minister. The newly-formed economic team aggravated uncertainty by announcing a rapid and contradictory series of policy changes.⁴⁶ Elite turnover gave intermittent influence on a diverse range of elite factions pursuing incompatible goals. For example, an influential adviser to Menem promoted "liberation" of the exchange rate, a repetition of the April decision. This incoherent policy — as before, there was no plausible means through which renouncing control over the exchange rate during a currency run would further the goal of low inflation⁴⁷ — opened the door to a second wave of hyperinflation.

Factional competition reached a fever pitch in the final days of 1989 as policy elites realized they were again on the verge of hyperinflation. Competing factions promoted a wide range of policy proposals to the new Economy Minister and President, who were "desperate"⁴⁸ for ideas to prevent a new crisis. One of these was a small network of policy elites promoting a plan they sometimes called "dollarization".⁴⁹ This faction initially achieved Menem's approval, but leaks — likely an effort by another faction to sabotage the plan from within⁵⁰ — triggered dramatic headlines in the final days of the year. On December 30, the large-circulation daily newspaper Clarin breathlessly proclaimed "[Authorities] develop plan to dollarize the economy",⁵¹ a sensational and confusing rumor that amplified uncertainty and contributed to the ongoing currency run.⁵² On New Years

Day, an emergency cabinet meeting rejected this plan and agreed instead to adopt the Plan Bonex, the default and expropriation measures described above.

7.2 Towards the end: The Plan Bonex

The Plan Bonex was a critical step in ending hyperinflation in Argentina (Beckerman, 1995). Without elimination of the unsustainable organizational structures generating the Central Bank deficit, definitive stabilization was impossible. It took elites almost a year to devise and implement a solution to this problem; consistent with the war of attrition model, this delay was a crucial part of the explanation for the crisis. But contrary to this model, distributional conflict between economic sectors was not the main reason for the delay. Also contrary to the model, there was no fundamental consolidation of political power enabling one group to impose costs on another. The main change was that the political cost of a deeply unpopular policy now appeared smaller than the return of hyperinflation.

To be sure, distributional issues were at stake: by effectively expropriating a significant share of wealth holders' assets, the Plan Bonex imposed substantial costs on a diffuse set of economic elites to end the prolonged crisis. But these costs were imposed by the state rather than economic elites: the Plan Bonex was adopted only after the Bunge y Born managers had resigned. Rather, short-termism and competition in a fragmented elite were the primary cause of delay. Elites working in the Central Bank drew up the proposal in the first months of the Menem administration, but internal opposition from Central Bank president González Fraga delayed its adoption.⁵³ Elites adopted the plan only when they were on the verge of a second hyperinflation.

Further, conflict in the factionalized policy elite of the early Menem government made implementation of the plan incoherent. The Plan's authors had already resigned due to elite conflicts, leaving the complicated reform without overall oversight.⁵⁴ In their absence, the Plan's primary advocate was Domingo Cavallo, the former central banker president mentioned above. Now Foreign Minister, Cavallo had no direct economic policy authority, creating friction with the Economy Minister. Soon after the plan was announced, these elites became enmeshed in multi-way conflicts over complex details with substantial distributional implications. Policy elite factions aligned themselves

with different positions,⁵⁵ forcing the inexperienced Economy Minister to intervene and resulting in more resignations in the Central Bank. Rather than resolve these issues, the government postponed key decisions for over a month, prolonging the climate of uncertainty.

Conflict between elite factions in different policy organizations, especially the Economy Ministry and the Central Bank, contributed to this chaotic policymaking process. As shown in Table 1 above, three different individuals served as president of the Argentine Central Bank in as many months. Policy conflict with the Economy Minister and other elites was the main reason for this high turnover rate. Policy debates provoked a series of high-level resignations the Central Bank, which ricocheted down the organizational ranks as allied subordinates resigned along with senior officials. This intense conflict rendered the Central Bank functionally inoperative; elites became paralyzed and incapable of major decisions, allowing unresolved issues to fester.⁵⁶ In the midst of hyperinflation, Argentina effectively did not have an operative Central Bank.

The incoherent implementation of the Plan Bonex was a major incentive for capital flight. After announcing the expropriation, elites granted a series of exemptions for specific categories of deposit holders in a chaotic and incremental manner drawn out over several months. Depositors exempted from the expropriation had a strong incentive to immediately exchange these funds for dollars, contributing to the currency run and thereby the rapid increase in prices. All told, these exemptions amounted to more than half the outstanding deposit base at the end of December.⁵⁷ The staggered way elites granted these exceptions extended the duration of the crisis.⁵⁸ After initially stabilizing in January, the exchange rate exploded towards the end of the month, fueling hyperinflation in February and March. Counterfactually, given that the currency run had essentially come to a halt, a consistent and coherent financial policy implemented at this stage could have avoided further hyperinflation. However, having first announced mass expropriation of savings and then partially reversing that decision, policymakers created an enormous incentive to wealth holders to convert funds to dollars. Thus, even a policy which finally addressed one of the root causes of the crisis — the Central Bank deficit — was implemented in an incoherent and contradictory manner, generating the second wave of hyperinflation.⁵⁹

8 Conclusion

As noted in the introduction, the Argentine hyperinflation resulted in large part from the effective insolvency of the Argentine state, and more specifically its Central Bank. Over more than a decade, a series of policy elites developed an incoherent and self-defeating monetary system; by early 1989, this problem required an urgent solution. However, Argentine elites postponed the eventual solution — effective default on the state’s monetary obligations — by over a year. When policy elites finally addressed the Central Bank deficit with the Plan Bonex, the policy was so poorly executed that it fueled a second wave of hyperinflation. Nevertheless, by mid-1990 the financial mechanisms generating hyperinflation had been disarmed, though definitive stabilization would take another year. This delay is one of the key features of the influential war of attrition model (Alesina & Drazen, 1991): accumulation of financial imbalances resulted in a much deeper crisis than would have occurred had state elites been capable of earlier action. But as has been argued, the political process driving this delay was not primarily a distributional conflict between economic sectors, but a broader pattern of elite fragmentation involving both economic and state elites.

Distributional conflict played a role not anticipated in the war of attrition model or in social conflict accounts of inflation (Hirschman, 1981) more generally. At the heart of hyperinflation lay a latent distributional conflict between wealth holders and agrarian exporters. The former sought dollars to protect the real value of their assets, while the latter were the main suppliers of dollars on the foreign exchange market. However, this latent conflict was not exogenous to state action, but dramatically amplified by the 1988 Plan Primavera, the collapse of which was among the proximate causes of hyperinflation. This incoherent policy reflected political constraints imposed by agrarian elites, but the main impact was to render economic policy contradictory and risky (rather than any direct impact on the state budget). Similarly, the 1990 Plan Bonex imposed severe distributional consequences by effectively expropriating wealth holders. From the perspective of the war of attrition model, the delay in adopting this policy must reflect the resistance of the losing side in the distributional struggle — in this case, wealth holders. However, there is no evidence that other economic elites lobbied for this solution. Indeed, when economic elites (the Bunge y Born group) briefly controlled economic policy, they failed to introduce measures capable

of ending the crisis. Rather than an exogenous factor driving the crisis, distributional conflict was substantially endogenous to the actions of state elites.

Rather than the main driver of hyperinflation, distributional conflict was one reflection of a broader pattern of generalized elite fragmentation in Argentina. The main explanation for hyperinflation is that elite fragmentation resulted in a chaotic and conflictive policymaking process that created contradictory and incoherent policies with perverse effects. The five mechanisms introduced above were on display to varying degrees at different moments of the crisis. First, frequent abrupt policy swings such as those of April and November 1989 created deep uncertainty, incentivizing capital flight. Second, short-termism and delay were key factors in the period immediately preceding hyperinflation: elites with short time horizons allowed the Central Bank deficit to fester, and the Plan Primavera was crucially shaped by the incentives of policy elites explicitly trying to hold on for just a few more months. Third, wealth holders had little confidence in elites' policy announcements (in standard language, policies lacked credibility) at least in part because of the reputational individualism of the Argentine policy elite, and because informed observers knew that incumbents' hold on state positions was weak. These reputation effects fueled the currency runs driving hyperinflation. Fourth, policies were often contradictory and incoherent to conflicts within the state; the clearest example is the outright factionalism prevailing in the first few months of the Menem administration. Fifth, conflict with economic elites — the distributional conflicts fueled by state action — imposed constraints on policy elites' options that also contributed to policy contradiction and incoherence.

This elite politics account subsumes aspects of both distributional conflict theories, as just noted, and institutional theories (Evans & Rauch, 1999; Spiller & Tommasi, 2007). The latter often cite high rates of elite turnover as a symptom of institutional weakness and point to short-termism and credibility problems as reflections of weak policymaking capacity. However, summarizing these dimensions as “institutional” effects ignores the elite competition and conflict that drives such processes. For example, Evans and Rauch (1999) cite the absence of shared norms, or malfeasance (corruption), among state officials. It is hard to see how normative anomie per se could result in the policies and pathologies that produced hyperinflation, and there is little evidence of outright

corruption in this domain. Rather, policy elites operated in situations of constraint due to competition and conflict with economic elites, party elites and other policy elites. It is these processes arising from elite fragmentation, rather than anomie or malfeasance, which provide an explanation for a crisis as extreme as the Argentine hyperinflation.

Elite fragmentation is a longstanding, structural characteristic of Argentine politics, and not merely a conjunctural feature of the 1980s. In this sense, the hyperinflation crisis is one manifestation of structures of elite competition and conflict that have generated macroeconomic instability over decades. Fragmentation and conflict also characterized elite politics during the later 2001 financial crisis (Van Gunten, 2015), and at time of writing Argentina is one of the few countries in the world with a rate of inflation above 100 per cent. The failure to stabilize inflation under the 2015–2019 conservative government of Mauricio Macri is an episode that could be used to further test the elite fragmentation theory developed here. Elite theory might also help account for other Latin American hyperinflation episodes in the 1980s, including in Brazil and Bolivia. Nevertheless, macroeconomic instability is also common in countries with relatively cohesive elites, such as Mexico; elite fragmentation primarily explains patterns of policymaking that promote macroeconomic instability, rather than directly account for crises as such. Further developments in elite theory should address these scope conditions.

Notes

¹Public interview sources include the Oral History Archive of Contemporary Argentina at the Instituto de Investigaciones Gino Germani, University of Buenos Aires (referred to as IIGG archive below).

²For purposes of analytical clarity, I disregard military rule in this exposition.

³This describes relations between party and policy elites in Mexico and Chile during some periods, for example.

⁴This describes the process of elite turnover in the Mexican policy elite, for example.

⁵As Economy Minister Juan Sourrouille put it, “I was never a Radical, at least not until [joining government]. . . I was more of an independent” (IIGG archive). An ally described their appointment as “a hard pill to swallow” for party elites (Mario Brodersohn, IIGG archive)

⁶See de Pablo (2011: 53)

⁷The lack of prior ties between these elites is summed up in their first conversation: “I didn’t choose you and you didn’t choose me” (González Fraga in de Pablo 2011: 57).

⁸Rapanelli in de Pablo (2011).

⁹Other economic elites, including industrial and commercial elite sectors also appear in the narrative below, but for analytical tractability I focus on agrarian elites and wealth holders.

¹⁰This category overlaps with many other social groups since practically *all* elite sectors (and some non-elites) held some liquid assets. Nevertheless for analytical purposes this is a meaningful elite bloc.

¹¹Inflation data are taken from the International Monetary Fund, International Financial Statistics in 2008. These data are no longer available from the IMF at time of writing.

¹²The latest transition from military rule to democracy occurred six years earlier. The 1989 transfer of presidential power from Alfonsín to Menem was the first transition between democratically elected parties to occur in decades. While this certainly created uncertainty, as noted above invocations of electoral uncertainty must contend with the fact that a distinct second wave of hyperinflation occurred after the elections.

¹³This was particularly true of the second wave: in the second half of 1989 the government deficit was small or even in surplus.

¹⁴In hyperinflationary settings “everyone watches the exchange rate as the signal for setting wages and prices” (Dornbusch 1985: 16).

¹⁵Consistent with this, Fischer et. al. (2002: 850) show that exchange rate changes preceded inflation in Argentina from 1967 to 1991

¹⁶A contemporary analysis of budget deficit found that in January–May 1989 (the period of accelerating hyperinflation) the deficit increased by 95% primarily due to falling revenue, particularly in value-added and capital gains taxes. Declining revenue was due to recession rather than tax policy changes. Spending declined but could not offset lost revenue. Source: FIEL reported by Clarín, July 2, 1989.

¹⁷Revenue increased from 17% to 22% of GDP from 1989 to 1992, but such levels of revenue were not unprecedented; a similar level had been achieved in the mid-1980s.

¹⁸Piekarz (1984) describes these challenges.

¹⁹Cavallo’s main goal was to reduce private sector debt, and he was not ideologically committed to free markets at this time (Cavallo and de Pablo 2001).

²⁰Beckerman (1992: 15).

²¹Machinea (1990: 36, 58) and José Luis Machinea IIGG archive.

²²José Luis Machinea and Juan Sourrouille, IIGG archive.

²³José Luis Machinea IIGG archive. The President’s reaction was “what do you want, for me to nominate [two conservative former officials]? No, I don’t have anyone but you and I’ll have to resign myself to that” (Torre 2021: 358).

²⁴In 1986, the central bank eliminated the monetary regulation account but replaced it with a functionally equivalent structure (Beckerman 1992: 13).

²⁵Machinea (1990).

²⁶At their peak, export taxes accounted for only about 10 per cent of revenues, and the lost income from export taxes was eclipsed by collapse of other revenue sources.

²⁷Machinea (1990: 77–78).

²⁸Policy elites hoped that this mechanisms would “produce a less negative reaction” than export taxes (Machinea 1990: 77), but the result was the opposite.

²⁹Juan Sourrouille, IIGG Oral history interview; Machinea (1990: 66, 73).

³⁰As one contemporary observed noted, “the big question that the financial market asks is whether the Central Bank can continue its exchange rate policy until the elections” (Graziano 1990: 28)

³¹As shown in figure 4, the growth in the Austral/Dollar exchange rate was approximately exponential (note the logged vertical axis; each tick represents a doubling of the exchange rate). The breakpoint analysis (Bai and Perron 2003) identifies deviations from this exponential trend, that is, moments when the rate of depreciation accelerated or decelerated.

³²La Nación, February 9, 1989

³³Machinea (1990: 75)

³⁴Pablo Gerchunoff, IIGG archive

³⁵Pablo Gerchunoff, IIGG archive

³⁶La Nación, 4/15/89 and 4/21/89

³⁷For example, La Nación, April 8, 1989

³⁸La Nación, April 20 and 26, 1989

³⁹González Fraga in de Pablo (2011: 56).

⁴⁰Bunge y Born held a near monopoly on grain exports in the early 20th century. By the late 1980s the firm had diversified into numerous industrial sectors, but still retained substantial agrarian interests.

⁴¹As noted above, the team amounted to “three or four” officials. These elites’ capacity was further undermined by the death of Economy Minister Miguel Roig barely a week into the Menem presidency.

⁴²For example, González Fraga unilaterally suspended policies which benefited agrarian exporters and discretely inserted a clause increasing the central bank’s autonomy into proposed legislation (Javier González Fraga interview).

⁴³ *Clarín*, Nov. 11, 1989

⁴⁴ Javier González Fraga interview

⁴⁵ For example, in mid-November Menem denounced ‘bad faith’ rumors about the Economy Minister’s impending resignation. *Clarín*, Nov. 17, 1989. The rumors were confirmed days later.

⁴⁶ For example, the incoming Central Bank President declared that the bank would not devalue the currency — and then promptly devalued.

⁴⁷ In the words of a prominent contemporary financial analyst, these measures were “totally inconsistent measures as a result of the intervention of various hands.” Miguel Angel Broda, *Carta Economica* No. 79, December 89–Jan 90.

⁴⁸ Cavallo and de Pablo 2001: 148

⁴⁹ Curia (1991)

⁵⁰ Eduardo Curia interview and *Clarín*, Dec 31, 1989.

⁵¹ *Clarín*, Dec 30 1989

⁵² Beckerman (1995: 678) cites “dollarization” rumors as a main cause of the second hyperinflation. While downplaying the importance of the rumors, influential financial analyst Broda conceded that rumors “gave [hyperinflation] an additional push” *Estudio Broda, Carta Económica*, No. 80, February 1990;

⁵³ González Fraga interview

⁵⁴ One of the plan’s authors, Roque Fernández, resigned due to fear of leaks; González Fraga prohibited the other from entering the Bank because the proposal was so incendiary. González Fraga interview

⁵⁵ E.g. *Clarín*, 1/14/90

⁵⁶ Anonymous interviews

⁵⁷ International Monetary Fund, “Argentina — Recent Economic Developments,” 26 November 1990, p. 37

⁵⁸ Some exceptions were announced in late February, six weeks after expropriation (de Pablo 2005).

⁵⁹ This interpretation of the second hyperinflation was advanced by Javier González Fraga, among others. González Fraga interview

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