Many commentators blame Argentina’s current economic problems on its decision to peg the peso one-for-one to the U.S. dollar. This policy has caused the peso to appreciate on a real effective basis, eroding Argentina’s international competitiveness and weakening its economic growth. Without exchange rate flexibility, adjustment can only come through wage and price declines, which proceed slowly. Many believe that devaluing the peso could lift the country from its economic malaise, but devaluation could seriously scar Argentina’s credibility.

Despite the peso-dollar peg, Argentina remains highly dollarized. This results partly from lingering doubts about the currency peg’s permanence, which stem from Argentina’s recurrent, worsening fiscal problems. Spreads between peso and dollar interest rates also reflect these doubts. Only recently has the country taken steps to rationalize a fiscal process that formerly promoted deficit spending and saddled the country with large public debts.

Argentina further rattled markets in early November with a debt-restructure plan that would require investors to accept lower-yielding bonds. Some viewed the plan as tantamount to default.

Whatever its macro benefits, devaluation would impose a harsh burden on the many Argentinians who have net dollar obligations. By raising doubts about the peso’s future value, devaluation would probably encourage further dollarization.