Argentina's economic crisis posed a harrowing problem for Eduardo Duhalde, the new president. The currency board system that set one peso equal to one US dollar for more than a decade had lost all credibility. While foreign exchange reserves were still roughly sufficient to back the central bank's Dollars 17bn or so of monetary liabilities, they were not enough to guarantee the Dollars 70bn of dollar and peso deposits in the banking system. Argentina was therefore vulnerable to the kind of bank run that eventually toppled the currency board: a financial panic that led to frozen bank deposits, a paralysed banking system and rioting in the streets.

Extricating the economy from the currency board was always going to be tumultuous. The new government had two plausible choices. One was devaluation or flotation of the currency. The other was dollarisation, ending the currency speculation by ending the national currency itself. Like many economists, the government sided with a 40 per cent devaluation. I fear that Argentina has taken the wrong path.

The case for devaluation is clear enough. The Argentine peso was not only under attack; it was overvalued. For once, the speculators had a clear foothold in macroeconomic reality. Once Brazil's overvalued currency was allowed to depreciate in February 1999, Argentina's currency board simply lost its credibility. The economy plummeted into recession as manufacturers shut up shop or shifted operations to Brazil. The refusal by Fernando de la Rua's government to adjust the currency board left the economy in free fall.

It is true that past breaks from pegged rate systems have led to renewed economic growth, most notably in Mexico in 1994, Russia in 1998 and Brazil in 1999. But Argentina's remarkable history of monetary mischief makes it an exceptional case. I do not know another nation with Argentina's capacity to abuse, manipulate, freeze, confiscate and periodically replace the national currency and the contracts set in it. The currency board was introduced precisely to break this record. Dollarisation would have ended it decisively.

The Duhalde government has shown two very different faces in its first few days. One is rather responsible, calling on the public to accept large shocks and fiscal austerity as the economy reorientates to a more realistic exchange rate.
The other is the red-hot Peronism of the past. Mr Duhalde himself has been a leader of this approach, claiming ominously that Argentina's collapse reflects an alliance of political power with financial power at the expense of industry during the past decade. The truth is much more prosaic: the currency board was a good effort that failed.

We cannot yet tell whether the government's various short-term machinations - price controls, dual exchange rates, abrogation of dollar-based pricing and indexation clauses - are just tactical moves to keep social peace and restrain a wage-price spiral, or whether they mark a return to prolonged ad-hockery and corruption. I am betting on the worst.

The president's attempts to blame the foreign-owned banks and utilities for Argentina's troubles, even if merely tactical, bodes ill for truth-telling in the difficult months ahead. Furthermore, the public will respond to red-meat populism. Argentina's need for international support in debt renegotiations will provide some counterweight to populism but it cannot by itself prevent a downward spiral of distrust and social unrest.

The alternative of dollarisation had a serious downside, to be sure. The peso was overvalued and dollarisation would have meant a fitful and prolonged reversal of the overvaluation. Nevertheless, it would likely have been preferable.

To begin with, a deal could possibly have been struck with the US government to reduce Argentina's costs of introducing US banknotes into circulation. The US might well have provided the Dollars 10bn or so of needed banknotes to Argentina at a price far below their face value, for example through some kind of swap arrangement or interest-free loan.

More important, dollarisation would have accomplished something that Argentine governments have not done in more than a century: it would have enabled them to follow through on a commitment to protect the value of the currency. This would have marked a historic breakthrough.

For that reason, too, it is likely that dollarisation would have allowed a faster unfreezing of bank deposits and restoration of public confidence in the banking system. Much of last year's bank run was of peso deposits fleeing an expected devaluation, rather than flight from the banks per se.

Devaluation, with the right accompanying policies, might still work. Yet in practice, we may well be on a course marked by a flagrant violation of property rights, growing confusion and corruption, arbitrariness and escalating social unrest.

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