Case--Argentina's Economic Turmoil and Solution

Argentina's Economic Turmoil Is Getting Worse

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Argentina has long been trapped in recurring cycles of deep and destructive economic contractions brought on by policies that force governments to routinely spend more than they collect through taxes and other income, economists say.

President-elect Javier Milei will take office in early December with the task of reversing unsustainable spending policies that have depleted government coffers and caused inflation and interest rates to soar .

Successive Argentine governments have resorted to printing money after exhausting other funding options such as borrowing billions of dollars from abroad, and the highly indebted country now finds itself cut off from global financial markets.

"Argentina's macro picture is in indisputable disrepair," said Alberto Ramos, an economist at Goldman Sachs.

The country has received more than 20 financial-aid programs from the International Monetary Fund since the late 1950s. It currently owes the fund more than $40 billion, making it the IMF's largest debtor . Argentina has defaulted on sovereign debt nine times in its history, most recently in 2020.

Argentina struggles to generate enough dollars through exports, and as foreign-currency shortages intensify, Argentines have little option but to protect their savings by rushing to the safety of the greenback, causing sharp peso devaluations.

Argentina today has nearly the same gross domestic product per capita, or total income divided by its population, it had 15 years ago. Tiny Uruguay's GDP per capita has grown by more than 40% over the same period, according to a study on rare macroeconomic disasters in Latin America by economists José Ursúa and Alejandro Werner.

Argentina is the only large economy in Latin America that has failed to bring inflation under control. One month of price increases is equivalent to what other economies in the region report over a full year. The country is expected to end the year with inflation at nearly 200%.

Since the turn of the century, most countries in Latin America have granted independence to their central banks so they wouldn't become a funding tool for governments set on expansive economic programs, but Argentina hasn't. Autonomous central banks set specific inflation targets and adjust policy to bring about price stability.

"Argentina is on a different track and it has become a significant discrepancy," said Martín Castellano, head of Latin America research at the Institute of International Finance, an association of financial institutions that also serves as a think tank on emerging markets.

Economists say that the country's money-printing machines have long been used to support government spending. The bank has had more than 60 governors, only two of whom completed a term—one in the 1940s and current Gov. Miguel Ángel Pesce.

Public spending began to expand sharply from 2003 to 2015 under two former presidents, Néstor Kirchner and his wife, Cristina Kirchner, representing 45% of GDP to pay for cash handouts, widened pension benefits and increased subsidies.

This year, the government's budget deficit is expected to widen to 5.6% of GDP, according to estimates by FIEL, a Buenos Aires think tank.

"Argentina's big problem is fiscal discipline, made even worse because the country no longer has access to debt markets," said Nicolás Gadano, the economic adviser of the Together for Change opposition coalition who previously served as central-bank chief of operations.

Argentines rush to the safety of the U.S. dollar as the Argentine peso is vulnerable to sharp devaluations. Severe restrictions on buying imported goods, making dollar payments abroad, and constant policy changes have also fueled demand for hard currency, economists say.

Residents use the beleaguered peso for basic transactions, but turn to dollars for savings, real-estate pricing, and conducting property transactions—sometimes with briefcases full of greenbacks. Argentines move their money outside the country and open bank accounts abroad at a much higher rate than in other countries.

Brandishing a chainsaw as a prop, the blunt and disheveled Milei campaigned saying that the money-printing machines of the central bank should be blown up and that the Argentine peso "is worth less than excrement."

The value of Argentina's imports and exports as a percentage of GDP is well below its Latin American peers. Unable to generate export revenue or access international markets, the country demands more dollars than it can generate. Lack of competition with foreign companies gives often inefficient local companies greater pricing power, contributing to higher inflation.

The shortage of dollars is made worse by the lowest rates of foreign investment in the region, despite the country's vast natural resources. Capital restrictions prevent foreign companies from repatriating profits. Importers face significant obstacles bringing in goods from auto parts to bus tires and other manufacturing components.

Many foreign companies have opted to pull out of Argentina, including airlines operating domestic flights and retail chains. Others have had to suspend operations as a lack of dollars inhibits their ability to pay foreign suppliers.

"The last man standing will inherit a dystopian economy undermined by runaway inflation, a deepening recession, widespread poverty and failing fiscal and monetary policies," said Arturo Porzecanski, an economist who specializes in Latin America at the Washington-based Wilson Center.

Javier Milei implements shock therapy in Argentina

The Economist; London (Dec 13, 2023).

When Javier Milei was sworn in as Argentina's president on December 10th he told the assembled crowd: "There is no alternative to austerity." Instead of rosy promises, he warned that tough times lay ahead. Announcing austerity upon taking office is usually political suicide in Argentina. Yet Mr Milei's sombre message was received with cheers. Fans raised chainsaws into the air, in reference to his promise to cut down the size of the state.

The inaugural address set the tone for the shock therapy to follow. On December 12th Luis Caputo, the new economy minister, unveiled a series of radical economic reforms. He announced a devaluation of the peso by over 50%, and promised to slash electricity and transport subsidies, halve the number of government ministries from 18 to nine, suspend public works and reduce federal transfers to Argentina's 23 provinces. The government reckons these cuts amount to almost 3% of GDP.

Alongside this, however, the administration will increase taxes on imported goods from 7.5% to 17.5%, and extend a tax of 15% on all exports (an existing tax of 30% on soyabean exports will be maintained). Child benefits will double, as will the value of a government food card for the country's poorest. The idea is to cut spending while temporarily increasing taxes to raise revenue, in order to lower the annual deficit from over 5% of GDP today to zero by the end of 2024. "We have come to solve the addiction to fiscal deficits," said Mr Caputo, noting that Argentina has been in the red for 113 of the past 123 years. The IMF, which is owed $43bn by Argentina, applauded the "bold initial actions" and promised to work "expeditiously" with the new government in the coming months. In a statement the fund admitted that the deal it signed in March 2022 with Argentina's government to restructure its loan had suffered "serious policy setbacks".

Mauro Roca, the managing director of TCW Group, an asset-management company, says investors are pleased with Mr Milei's pragmatic turn. The new president rose to fame promising to dollarise the economy and shut down the central bank. Yet since being elected in mid-November, he has put plans for dollarisation on hold and sidelined loyalists. Instead, he has stuffed his cabinet with technocrats from the main centre-right coalition, Together for Change, which held the presidency from 2015 to 2019.

Things may get worse before they get better. In the short term, these measures will lower growth. Given that a cheaper peso, new taxes and fewer subsidies will make living more expensive, there is a chance that prices could rise even higher. Martín Rapetti, a consultant, believes monthly inflation will at least double to around 20% and remain high for several months. But that is far from certain. Mr Milei's emphasis on fiscal discipline may reassure markets that Argentina is not headed for disaster—if they choose to believe him. That would quickly pull inflation down, rather than push it up.

The confidence of the market "will depend on the degree of social conflict", says Mr Rapetti. Since Argentina's return to democracy in 1983, all but one non-Peronist president has been booted out of office by protests against economic reforms. Social organisations were quick to respond to Mr Caputo's announcement. Demonstrations have been called for December 20th.

Mr Milei may also face pushback from his base and from Congress. On the campaign trail he promised to cut taxes and said spending cuts would be paid for by the "caste", a term he uses to refer to corrupt politicians. Yet taxes will now increase significantly, at least temporarily, and austerity will affect far more than just public workers. His coalition has only 10% of seats in the Senate, and 15% in the lower house. On average since 1983, presidents have commanded the support of 45% of Congress, according to Ana Iparraguirre, a political consultant.

Mr Milei is using his political capital now to pass tough reforms in the hope that the economy will begin to recover by mid-2024. The question is how long the pain will last.

Measuring Milei's Argentine Progress

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On a wall outside the office of Argentina's deregulation czar, Federico Sturzenegger, hangs a kind of countdown "clock." It registers—not in hours and minutes but in days—the time remaining until the expiration of a special law that grants President Javier Milei's government sweeping legislative powers for one year. Congress passed the law in June. Last week, when I called on Mr. Sturzenegger, he proudly drew my attention to the illuminated sign, which read "217 days left."

Argentina is a regulatory nightmare in which red tape, growing like kudzu over generations, chokes off innovation and risk-taking. Mr. Sturzenegger is charged with cutting it down to size. He also leads the "transformation of the state." But once the omnibus law expires, his super powers will go with it. If the government has to go back to negotiating with Congress—where Mr. Milei's Liberty Advances party is in the minority—reform is likely to slow down at best. Thus the clock: Mr. Sturzenegger is a man on a mission.

Mr. Milei begins his second year in office on Tuesday. He inherited a large fiscal deficit, swelling debt and a 2023 inflation rate of more than 200% from Peronist former President Alberto Fernández. At his inauguration Mr. Milei was careful to warn the nation that recovery would be painful. He's been right. The economy is expected to contract 3.5% this year and annual inflation will finish 2024 near 120%. Even so the president's public approval is above

50%. He scores higher in public trust than any of the past three presidents after 12 months in office.

Milei supporters are convinced that things would be much worse if not for their chain-saw-wielding president. He's their David fighting the Goliath state, a reckless central bank and regulatory capture by special interests—from labor unions and nongovernmental social organizations to domestic producers. The recession is probably over and next year the economy might grow 4% to 5%. Country risk has fallen sharply. Inflation still isn't whipped—prices are forecast to rise around 30% in 2025—but relative to recent history it's tame. For now he can boast a softer-than-expected landing and some stability, which a year ago seemed out of reach.

Skeptics have reason to fret. The government brags that it has reached fiscal balance. But as a recent paper by economists Sebastian Galiani at the University of Maryland and Santiago Afonso at the University of Buenos Aires explains, Milei technocrats used surging prices in the first six months of this year to get there. "The administration," the authors write, "has heavily relied on inflation-driven cuts to social spending and public investment rather than on structural reforms."

Mr. Milei has backed off his campaign promise to close the central bank and dollarize, which could turn out to be a fatal miscalculation. Exchange and capital controls remain in place and the peso is overvalued, making the country very expensive in dollar terms. Cristina Kirchner, convicted in a $1 billion kickback case in 2022, is now head of the Peronist party that has a plurality in both congressional chambers. Mr. Milei's negotiations with her are making advocates of the rule of law and institutions nervous.

Changes at the micro level are more promising. Early on in his tenure Mr. Milei used emergency powers to eliminate rent control and amend scores of other economically repressive laws. Mr. Sturzenegger's task is to deepen and broaden what Mr. Milei began by dismantling the legal architecture guaranteeing many other privileges and protections to organized groups (aka rent seekers) at the expense of the wider population. "Their power is written in the law," the minister says.

The Massachusetts Institute of Technology-trained economist told me that he came to the government having spent a year and a half mapping the country's regulatory landscape. He identified more than 4,000 laws, 70,000 decrees and countless resolutions that discourage investment and entrepreneurship, bar competition and damage productivity.

Price differentials between the international and domestic market are one measurement he uses to prioritize his agenda because wide variations often signal barriers to competition. It's no coincidence that Argentines pay five times what Spaniards pay for medications and that the local pharmaceutical industry is heavily protected by regulation. I was surprised to learn that importing some used capital goods is prohibited and in other cases unbearably cumbersome. But not for long, Mr. Sturzenegger said. Last week he announced on X that the ministry would eliminate the bureaucratic complexity required to start a business and streamline product registration.

A web portal that welcomes comments from the public has helped Mr. Sturzenegger identify "themes." He's discovered a rough rule of thumb: Where deregulation happens, prices decline in the range of 30%. He has seen it in textiles, logistics and some agricultural products—and the deregulation job is only 20% along. That's good and bad. The clock is ticking.

Questions:

- What are the major problems of Argentina's economic growth? Figure out 3 to 4 most severe problems in your point of view and organize them in a systematic way.
- What economic policies are proposed by President-elect Javier Milei? What are the benefits and costs of these proposed policies? Choose 1 or 2 policies for analysis: How could they address the major economic problems you figure out above? At what costs?
- After one year of Milei's rule, how are reforms in Argentina progressed? What are the main challenges at this stage?