

EconoFact Chats: Argentina's Economic Challenges

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Published on April 14th, 2024

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I'm Michael Klein, executive editor of EconoFact, a nonpartisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Charles Collyns

Hi, I'm Charles Collyns, senior advisor at EconoFact. Before joining EconoFact, I worked at the International Monetary Fund, the IMF, for many years. The IMF is the international organization set up to help countries that face a balance of payments crisis, or in layman's terms, to help countries that cannot pay their bills. One of the countries I worked with, indeed on several occasions, was Argentina. In fact, Argentina is one of the IMF's most frequent clients, and right now, it's the Fund's biggest borrower, owing almost \$50 billion. Why does Argentina have this dubious distinction? It's a real puzzle. Before the First World War, it was one of the wealthiest countries in the world, with rich agricultural resources, an educated middle class, well-developed ports and railroads...it's elegant capital city, proudly known as the Paris of Latin America. Since then, however, its economic ranking has tumbled. The country is now ranked 66th worldwide in terms of real income per capita, and it repeatedly appears on the headlines as a country in crisis, defaulting on its debt, racking up record rates of inflation, and heading to the IMF for massive bailouts. It now has a new president, Javier Milei, who was elected last year, promising a radical agenda to turn Argentina's fortunes around. To discuss Argentina's dire economic performance over the past decades, and whether it can escape this miserable destiny, I'm very pleased to welcome to EconoFact Chats Alejandro Werner. Alejandro is an expert on Latin America's economies. He served as senior official in the Mexican Finance Ministry, and subsequently as director of the IMF's Western Hemisphere Department. He was in this role when Argentina came to the Fund for a massive loan in 2018. Currently, he's the founding director of the Georgetown Americas Institute and is the author of a recent book, 'Argentina at the Fund.' Alejandro, welcome to EconoFact Chats.

Alejandro Werner

Thank you for the invitation, Charles. It's a pleasure to be here discussing Argentina with you.

Charles Collyns

No, indeed, this is a fascinating topic. I think both of us are truly interested in Argentina, but also not just because of the intellectual interest, but because I think it has important lessons beyond

Argentina for the rest of the world. Perhaps to start, you could give us some sense of just how poor Argentina's performance has been compared to other countries.

Alejandro Werner

Around 1911, Argentina had an income per capita adjusted by purchasing power parity that was higher than the US and Canada. Now, Argentina's GDP per capita adjusted by PPP is less than one-third of the US and Canada as well. From 1930 then to 1950, Argentina fell from being the 12 richest country in the world, to being the 19th country. And then from 1980 to 2023, it went from being the 35th richest country in the world to being the 69th richest country in the world. So we're really looking into a story of how Argentina converged from above, to the average income per capita of the large Latin American economies. And that is why, I mean, some people, I think, attribute this quote to Simon Kuznets that actually says that there are four types of economies in the world, developed economies, underdeveloped economies, Japan and Argentina. Because Japan and Argentina present, really very different evolutions that makes it hard to put them in some of the traditional boxes where we like to analyze different economies.

Charles Collyns

I think Japan has become a more normal country in recent years, but it's striking that Argentina is still one of Kuznets's outliers.

Alejandro Werner

You're totally right. And even some of the most recent puzzles in Japan, like living with those very high levels of debt, are becoming more common with other advanced economies, significantly increasing the levels of debt. So you're totally right. I mean, I was going to highlight that in the last 120 years, Argentina basically went through nine episodes of – we borrow the term from Barro and Usua called rare disasters. And that's, I mean, episodes that can be one year, or five years in which the country accumulated a drop in GDP per capita of more than 10%. So Argentina actually went through nine episodes in the last 130 years in which the economy fell a cumulative percentage higher than 10%. So it's one of these extreme cases of a country that has basically converged from being an advanced economy to being an emerging market. And now, I mean, obviously, in Latin America, we have an even more complex case that is Venezuela. Venezuela actually from 2014, 2015 to 2020 or 2021 suffered a 73% contraction in GDP per capita being one of the largest cumulative contractions that an economy has suffered in modern times, only compared to what Nazi Germany went through during the Second World War. And finally, I mean, to showcase a little bit the extremes that the Argentinian economy has gone through – when we start looking at the Argentinian economy from 1970 and beyond, that's when Argentina started experiencing significant financial problems that were manifested in very high inflation. For example, in the 70s, Argentina had some years with inflation higher than 400%. In the 80s, inflation accelerated significantly to 3,000% by the end of the 80s. In 1990, after

reaching these 3,000s - 2,000% inflation rates, Argentina decided to drop its currency through the use of a currency board. Basically, they kept the Argentinian Peso, but they said that the central bank would not be able to issue pesos unless it had a 1 to 1 dollar backing with reserves at the central bank. So they moved to what is called a convertibility of a currency board. And they stayed with that for almost a decade. And at the end of the last decade of the previous century, in 2000-2001, several things happened. A significant appreciation of the dollar, and therefore Argentina by the one-to-one peg inherited that very high value of the dollar at the time where the Brazilian Real, its main trading partner, depreciated significantly. And also it went through a period of low prices for its main exports that are agricultural exports. Argentina was not able to sustain this parity and it had to let go of the currency board. And that generated an extreme financial crisis at the end of the year 2001. At the back of many of these problems were a very profligate fiscal management that led Argentina to live either with high inflation, or with periods of significant accumulation of debt that led Argentina to nine episodes of debt default, and to 22 programs with the IMF now going towards 23. So that's a little bit of description with some of the numbers of the financial, fiscal problems that Argentina has gone through.

Charles Collyns

So perhaps we could now move to focus more on the most recent history, and the period where you were involved when you were at the IMF. How did Argentina get into the particular mess that it's in today? Going back to the period before the 2018 Argentina loan, can you sort of give us a good overview of this most recent period?

Alejandro Werner

So let's go back to the breakdown of convertibility in the early 2000s. So Argentina went through a very deep crisis then, a high turnover of precedents in a few weeks, and eventually it settled down with a relatively unknown political figure from a southern province of Argentina that was Nestor Kirchner. Nestor Kirchner was able to stabilize the country, and then he was blessed with one of the largest wealth increases that Argentina has seen recently, basically the terms of trade boom led by the growth of China, the huge consumption, and increased demand in commodities that China injected into the world economy, let's say starting in 2003, towards 2015 – that created a windfall gain for Argentina, and the way we measure it is basically looking at what Argentina was exporting in 2003, the prices at which was exporting soy and meat, and other agricultural product, and then if we keep quantities kind of constant and we just use the way that prices behaved in 2004-2005, the same level of exports, but only because of the effect of higher prices generated a windfall gain for Argentina of around 100% of GDP – Cumulative. I mean this was a 12-year period but it's kind of Argentina getting a gift of 8% of GDP per year for a period of 12 years. Argentina then was able to significantly recover from the crisis of the 2000s, but instead of saving an important amount of this, let's say, non-permanent windfall gain, it spent a very large percentage of this, and that led the government to double the size of its expenditures going from

a level of government expenditures of 20% of GDP to 40% of GDP. When terms of trade stopped increasing, stabilizing, some years started falling, then Argentina started getting into financial problems again, but it was still able to manage it with relatively high inflation but without a bust. Together with that, the government of Nestor Kirchner that was succeeded by two terms of his wife, Cristina Kirchner, significantly deteriorated institutions, there was an important increase in corruption, etc., so Argentina's population basically ended up voting them out. But the way that Mauricio Macri interpreted his win in the 2015 election, going into 2016-2017 was basically that society gave him a mandate to really change the institutional setup that the Kirchners have undermined, rather than a mandate to transform the economy, and that is why Mauricio Macri moved faster in fixing the institutional setup, making institutions more transparent, more accountable, strengthening the rule of law, but he went very gradual in fixing the fiscal situation, fixing the monetary situation, and he went relatively fast in opening up the capital account. All of this in a period in which interest rates in the world were, I mean, near zero, so capital markets kind of accompanied the experience that was called gradualism of Mauricio Macri for a while, but eventually they saw that the political situation was not that solid for a continuation of these types of regime, and in 2018 they started having significant troubles in funding their budget needs and that's why they turned to the IMF. One final comment on these starting conditions for the IMF program is that it's very hard to question Mauricio Macri's assessment that he didn't have a mandate to transform the economy. I mean, one can have different views, I'm not an Argentinian politician, I wouldn't second guess him on that. I think what is questionable is thinking that the political constraints to not being able to do a very fast adjustment of the fiscal accounts was going to be overlooked by the markets, and by investors, and they were going to invest in Argentina for the long term knowing that the government was not being able to fix the financial situation because politically they didn't have the support. So there was a contradiction in their diagnosis that the gradual approach to fiscal and financial issues could go hand in hand with the fast recovery of the economy that will allow Mauricio Macri to do the adjustment in the future. If the political constraints were so strong that you were not able to do the fiscal adjustment, then investors would take into account those political constraints and be much more cautious in investing in Argentina. I think that was an important problem.

Charles Collyns

So that is the question, how did the IMF think it was going to help deal with this fundamental tension between long-term economic goals and the short-term political goals?

Alejandro Werner

So in a way the IMF faces an important dilemma in these situations. You had a government in 2019 that at that point that needed to move very fast, [and] do a much more front-loaded adjustment. They have full ownership in doing that. On the other hand you were facing very complex political environment because in two years there was going to be an election in the

country and very hard to visualize that in two years the government was going to be able to turn things around in such a strong fashion so that the new economic model was going to get voted into power again and sustain after the election. On the one hand the international community can support this effort knowing that it's very risky, or the international community can decide not to support it, and actually guarantee that it's going to be impossible for Argentina to reform because if you don't support that effort then it's very likely that Argentina will go into a crisis, and given the crisis then you will have a non-reformist government implementing policies again in Argentina. So I think being a super senior creditor, the IMF is an institution, and the international community through the IMF to actually take that risk, especially if you have a government that is willing to implement those policies. Obviously in those 18 months the interaction of very tough economic measures with a highly charged political environment, and then electoral campaign, ended up giving way to an election result that brought back into office the populist policies that we saw in the past. Alberto Fernandez' government, and also facing with the pandemic, but more than that having the wrong diagnosis of the economy I would say Alberto Fernandez and thought that the problem for Argentina was high debt, and not that high debt was the consequence of the bad policies and the disequilibria that a very high deficit was created in Argentina, only focused on restructuring private sector debt, re-profiling the IMF program, but not doing significant reforms and that's why they got to the end of their government with the 200 and something percent inflation that we mentioned, with an economy that has been stagnant for the last 15 years or actually declining, and that's when Argentinian population really elected a complete outsider that actually ran on a platform that he was going to significantly slash government expenditure, get rid of the of the currency, and open up the economy to competition, and that's Javier Milei that you mentioned in the introduction.

Charles Collyns

So how is he doing? He's had five months so far. Can you give him like a half-time report card, and what do you see is going to be the challenges that the government is going to face in the years ahead?

Alejandro Werner

It's significantly early to call it half time, but let's say that for five months I mean Milei has announced a huge fiscal adjustment of five percentage points of GDP, a commitment not to print money unless he acquires international reserves, and then he sends an important decrees and legislation to really undertake a huge modernization and freeing up of its economy by freeing the labor market, by reforming pensions, by reforming taxes and by really making the labor market much more flexible, privatizing companies etc. All of that is still being negotiated with the political system. On the macro front he has moved very very fast in doing the fiscal adjustment, helped by a significant increase in inflation that has basically allowed him to reduce real expenditures significantly, and to bring down inflation faster than what people saw. So I would

say that on the macro side he has done pretty well. On the structural side, still highly dependent on an important negotiation in Congress and with the provinces. And we have to remember that he got around 55% of the votes in the second round, but Congress and local governments are totally occupied by the opposition parties, so his political strength comes from his public support, but politically he has to negotiate with a Congress that is led by the opposition. Now he's in a good position to do that, because local governments are much more stretched of resources than he is, and therefore he should take advantage of the current opportunity to make a big bargain both on budgetary terms, on tax terms, but also on the structural issues that will allow him to govern let's say between now and the midterm elections, according to his three main objectives that are reducing the size of the government, significantly reducing inflation, and opening up and modernizing the economy. And then in the midterm elections it will be some kind of referendum towards whether Argentinian population wants to continue on this path, or go somewhere else. So I think so far he's done very well on the macro, and a big question mark on the structural reforms where he will need significant political skills to really advance at a very good pace and basically open up, and free up the Argentinian economy.

Charles Collyns

Yeah as you say, the politics is crucial. You've got to find a way of having the politics reinforce the economics, and for the economics to reinforce the politics. We're going to have to wrap up, but I'd be really interested to hear any final thoughts you may have about the lessons of this experience. As you mentioned that as you look across Latin America you see somewhat better performance in many countries, but I'm sure there are still lessons to be learned from Argentina, and maybe also some lessons for the IMF in how best they can help countries going forward.

Alejandro Werner

You're totally right I would say that the lessons for the rest of Latin America coming from Argentina today are the lessons maybe in terms of politics. In a way, how the breakdown of the old political system, and not being able to deliver to their populations opens the way to these complete outsiders to govern – that actually present a very uncertain option for the countries, because I mean we all hope that Milei will be successful, but obviously the significant political weaknesses that he has makes this experiment extremely risky, and that I think sends an important lesson for countries that are not going through such deep problems in their economies as Argentina, but are seeing very fast polarization of their political and social environment that could open the window for outsiders that most of the times end up being very costly experiments. So I think political classes should take note, and try to move a little bit more to the center and try to move a little bit more to consent, to advance the reforms that countries need, to avoid this total breakdown of politics. On the Fund side I think the Fund should recognize...that it recognizes that for IMF programs to be successful you need maybe 80% of ownership of the country. Not only the government, but the country in trying, to reform maybe, you need 10% of the

international community, and then you need 10% of improvements in the design of the program. But the most important element for success is the commitment of society spear-headed by the government, but supported by an important percentage of the political class – that is the way to go. And then the IMF can increase the probability of success by providing financing and providing technical assistance and advice. However, even if the probability is low, one has to decide, as a representative of the international community, if it's better for the international community to support these attempts at reform, or basically to leave these reformist governments hanging from a thread. And that I think where the IMF should, as it did, but maybe in a much more clear way support these programs knowing that they're extremely risky, but knowing that the IMF in the long run will get repaid given that it's a super senior creditor. On the other hand when you don't see the commitment from the government, and even less so from society, I think the IMF should be much more inclined to actually pull the plug out from these programs, and that's what the IMF did not do with Alberto Fernandez, a president that signed a program with the IMF, and had no intention in actually implementing that program. I think in those instances the IMF should be much more decisive in just separating itself from those programs, and wait until a new government is willing to form the societal consent around the right policies, and then go back to the countries and support these new experiments

Charles Collyns

No thanks Alejandro those are wise words of caution to end up with. You know, thank you so much it's been really interesting hearing you. You've been masterful in the way you've blended so much of the history of Argentina of so many years and in a way that I think people will really relate to. Hopefully we'll be able to look at your book with people interested in more detail on the more recent history of Argentina at the IMF. But at the moment I think it's just available in Spanish but is it going to be the English version or we will need to polish our Spanish skills?

Alejandro Werner

I mean so far it's in Spanish it's called, as you said, 'Argentina at the Fund' that in Spanish means at the bottom and at the IMF so it's kind of a play on words. And hopefully we will be able to do something in English and as is always the case in Argentina the more we wait the more we have to write about.

Charles Collyns

Well we can't wait forever, but thanks so much Alejandro it's been great talking with you. Really, really appreciate you joining with us today. Thank you.

Alejandro Werner

Likewise Charles, thank you very much, bye.

Michael Klein

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