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Economic Viewpoint

Notes by Danny Leipziger*

How to Explain Argentina and where It Is Headed?

One of the current economic mysteries is Argentina, one of the few countries to default on its debt, one of the few to register persistently high growth rates in recent years, and one very difficult to understand as its economic management is idiosyncratic. According to the family that runs the country, they have a unique Argentine model. Some would say that the model includes: 1) a desire for financial self-sufficiency in which the private sector is induced to help support the populist public sector; 2) the use of all presidential powers without regard to the judiciary; 3) creative intervention in markets, including affecting prices and manipulating national income and price data; 4) subsidies to the lower end of the distribution paid for by the upper deciles which seemingly are earning enough not to object and; 5) the creative use of uncertainty which keeps everyone guessing as to the next policy announcement.

One might expect such a model to produce disastrous results; yet, with the fortunately high level of commodity prices and by virtue of being shut out of the international capital markets, and thus, untouched by the subprime crisis, Argentina has been doing spectacularly well in recent years. Its growth rate has been high. It has run current account surpluses. And if you believe the official price data, all is well. Well some of this is true. External factors have favored Argentina of late; however, the reality is that: a) capital flight since mid-2007 totals about $42b.; b) the fiscal surplus that the country enjoyed, partly because of the confiscation of the private pension system and the capture of mandatory contributions in the public National Administration of Social Security (ANSeS) system, is eroding quickly; c) growth will be negative in 2009 and the poverty rate is perhaps 50% higher than official estimates, using correct inflation and price data; d) the combination of poor weather and the high and unremunerated export taxes will shrink commodity exports, although soya will still do well; and e) the government majority in the Congress will end with the June elections (although in rare Argentine style, the new legislators will govern for 6 months before being replaced) and uncertainty will rise even further.

Argentina won't collapse because its agricultural sector is competitive and industry may rebound in 2010 as the Brazilian real appreciates. Rising labor costs will mandate a weak exchange rate and help exports. The bigger problems are longer term and will face the new administration in 2012. As a result of significant price distortions, particularly in the energy sector, Argentina has frittered way its remaining natural resources, and the need for infrastructure investment is becoming more obvious. At the same time, the insecurity of financial assets has led to an off-shore balance of $180 b. by Argentine residents, money better invested at home. High inflation risks creating a new wage-price spiral. The fiscal position is weakening and farmers have had enough. Despite all signs of trouble ahead, the model promoted by government still works because the elite still manage to earn well, the poorer segments of the population receive benefits, and the large middle of Argentina's income distribution has yet to express its disapproval in any meaningful way.

Going forward, one cannot help contrasting Argentina with Brazil, where tax collections are high and domestic investment booming. Brazil has brought down its external debt and has been fiscally responsible over the four terms of the past two Presidents. Argentina by contrast is making many decisions that entail long-term costs for the economy and for society. No social compact has been forged that enables government to act responsibly enough to ensure long-term sustainable growth. And most regrettably, Argentina has squandered a golden opportunity to make a big leap forward.

The views expressed here are personal and do not represent necessarily the position of either the World Bank Group or its Board of Executive Directors. Comments can be sent to Dannyleipziger@gmail.com.