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**Argentina's new president
will have public support to
end 'perpetual' crisis**

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Executive summary

- Argentina's new president will take office in December. Whoever wins the elections in what is now a three-way race, will face a daunting 'in-box' including surging inflation, acute dollar shortages, foreign debt payment difficulties, and the possibility, if improvements don't come quickly, of social unrest.
- The next government will struggle to turn around the country's long term economic decline. Some analysts attribute that to the populism of the Peronist movement, which has dominated Argentine politics since the 1940s. However, populist positions have been adopted elsewhere across the political spectrum with misguided suggestions that there can be quick wins to complex problems like inflation and crime.
- The last two governments of presidents Mauricio Macri (centre right) and Alberto Fernández (centre left) highlighted their ideological and political differences, but their economic performance was similarly poor.
- Primary elections held in August suggest Argentina's electoral landscape is shifting from a two-way to a three-way split, a change that could have far-reaching consequences for the new government. No single party or coalition will control the new congress and any economic recovery programme will require the support of more than one congressional grouping.
- Full dollarisation of the Argentine economy is a policy option under consideration. However, the idea is unlikely to progress because of a lack of the initial billions of dollars needed to launch it, and because of congressional opposition. That said, the next president will consider other ways of delivering a positive 'confidence shock' to the currency; the new government will also need, once more, to renegotiate IMF support.
- The new government will benefit from some positives, including a likely increase in exports as the farm sector recovers from this year's historic drought, increased natural gas production through new pipelines, and exports from the massive Vaca Muerta deposits in Patagonia. Prospects for the mining of lithium and other metals are also encouraging.
- The fact that no party or coalition will hold a congressional majority is a double-edged sword. It could create a damaging legislative deadlock or more positively it could force the new president to negotiate cross-party support for a comprehensive programme of reforms needed for short term recovery and long-term transformation.



The need to reverse a long decline

The fundamental challenge for whoever wins Argentina's 2023 election, as for so many of their predecessors, is how to reverse the country's long decline. Historians and others have sought to explain why Argentina has fallen back in global economic rankings over the last 100 years. In the 1920s Argentina was one of the ten wealthiest countries in the world, measured in terms of GDP per capita. By the beginning of the 2020s, however, it had fallen to around 65th in the global ranking, as measured on a purchasing power parity (PPP) basis by the IMF. On other measures Argentina is even further down the ranking. Understanding the structural and long-term factors at work in this prolonged decline might help the country's next president to at least begin to turn the process around.

One attempt to explain the cause of the decline is contained in a working paper by Rok Spruk, entitled 'The Rise and fall of Argentina'¹. Broadly speaking it identifies a golden period of liberal economic policies, growth, and reform, known as the Belle Epoque, and running from the adoption of the constitution in 1853 to the beginning of the First World War. Along with others, Spruk argues that something went seriously wrong for Argentina after the First World War. He describes it as a lack of inclusive institutions capable of preventing democratic reforms from being eroded or bypassed. Politics became deeply divisive with conservative forces resisting, first, the political rise of the middle classes at the start of the 20th century, and, second, the political rise of the working classes from the 1940s onwards.

In Spruk's view long run development "can be easily undermined if powerful interest groups bend the institutional framework to their own advantage through distortionary policies". One example was the military coup of 1930, which unseated the middle-class based government of Hipólito Yrigoyen. The ensuing military regime quickly created a dual exchange rate to allow it to benefit its political allies.

The Peronist movement started out in the 1940s and sought to incorporate the urban working class into

¹ Spruk, R. (2018) 'The rise and fall of Argentina', *Mercatus Working Paper*



the political system. For half a century (1946 to the Falklands/Malvinas War in 1982) Argentina was locked in a power struggle between Peronism and a deeply conservative military. Defeat in the South Atlantic conflict effectively sent the military back to barracks, but a deep partisan fault line, known as *La Grieta*, has continued to divide the country between Peronists and anti-Peronists.

Some historians blame Argentina's problems on an excess of populism in general, and on Peronism in particular. Peronism is the political movement founded by General Juan Domingo Peron, who held office for two periods, in 1946–1955 and 1973–1974. His movement gave voice to the previously disenfranchised working classes. Perón advocated a 'third way' between capitalism and socialism, nationalised key industries, and redistributed money during export booms to win political and clientelist support. Liberal critics of Peronism have highlighted its authoritarian tendencies, and its use of large fiscal deficits to distribute largesse among trade unions and popular organisations, avoiding the economic reforms needed to make Argentina more competitive in a globalised economy. Peronism has over the years split into multiple left- and right-wing factions. In recent years the left-wing *kirchnerismo* faction (loyal to

Vice President Cristina Fernandez de Kirchner) has been prominent, but it has recently lost support.

But if populism is defined as a political movement which seeks short-term gains and which claims to represent the people in a struggle with the elite or the establishment, then it is clear that it stretches far beyond Peronism. The common thread is a pursuit of short-term political benefit based on economic policy manipulation by rent-seeking lobby groups. The military regime of 1976–1983, deeply opposed to Peronism, nevertheless followed populist policies such as over-valuing the currency to create a short but unsustainable boom (a period known as *plata dulce* or 'sweet money' which boosted middle class consumption). That same regime eventually tried to play a nationalist card by occupying the Falklands/Malvinas islands, an operation that proved to be politically and militarily disastrous.

Many governments of both right and left have continued to run fiscal deficits while printing money to fund them. Even populist challenger Javier Milei's brand of Chicago Boy market economics is presented within a populist wrapping, with promises to fight the elite and deliver almost instantaneous economic gains.

Macri and Fernández: not that different?

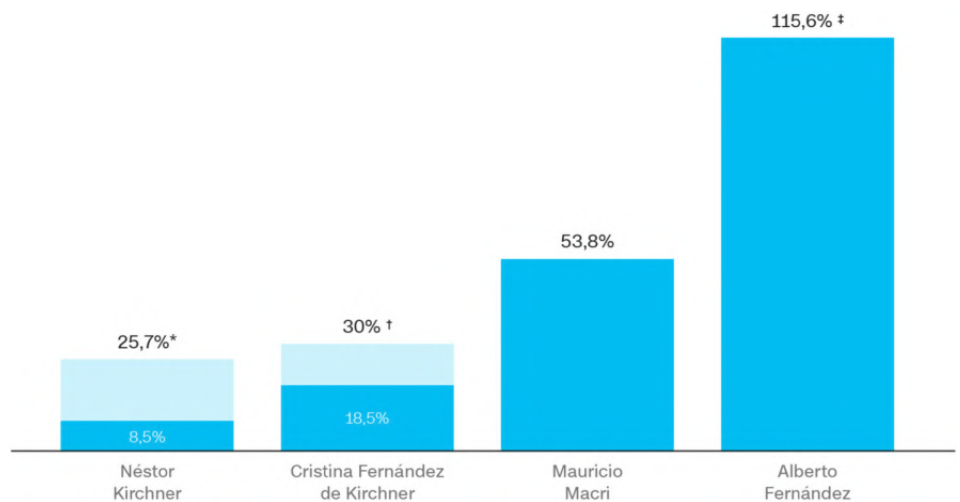
In the early years of the 21st century Argentina has seen the political pendulum once more swing between Peronists and anti-Peronists. It is worth making some brief comments on this recent period. The country experienced centre-right rule during the government of Mauricio Macri (2015–2019) and centre-left rule during the government of Alberto Fernández (2019–2023). While there were significant policy and ideological differences between these two administrations, they both failed to reverse a steadily deteriorating national economic performance.

As shown in Figure 1 the Macri administration took office with an annual inflation rate of 30%, which had risen to 53.8% by the end of his term. The Alberto

Fernández administration saw that rise again to 115.6% by mid-2023, its last full year in office. As shown in Figure 2 GDP growth figures were equally disappointing. The economy contracted in three of the four years of the Macri government, achieving a negative average growth rate of -0.9%. Assuming GDP will drop by around 2% this year, the Fernández administration will have seen two years of growth and two of contraction, achieving the same negative average across the full four years as its predecessor, -0.9%.

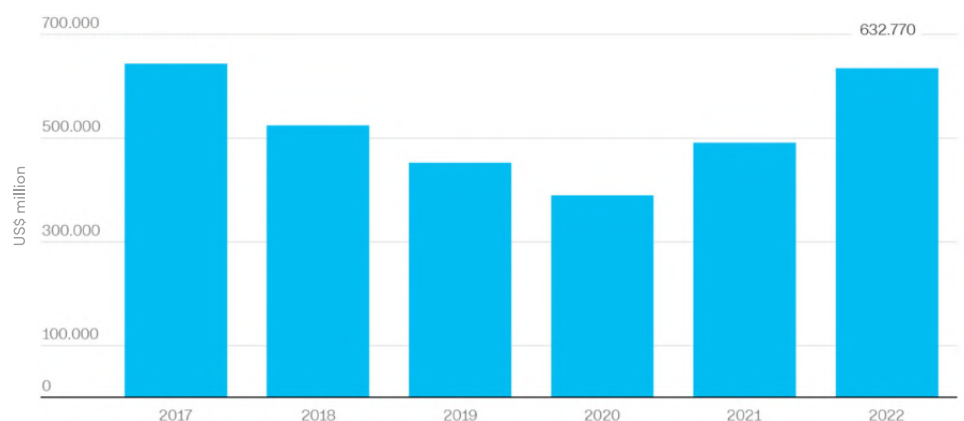
The Macri administration moved quickly to drop exchange rate and capital controls, as well as rescheduling the heavy foreign debt. Initially this looked successful with new loans and investment

Figure 1:
Inflation at end of term



Source: Banco Central de la República Argentina

Figure 2:
Gross Domestic Product



Source: World Bank

flowing into the country and the peso stabilising on the foreign currency markets. However, as in the times of *plata dulce*, some of the inflows were speculative and the improvements proved not to be sustainable; opting for a gradualist approach to soften political opposition the government failed to control the fiscal deficit. By 2018 Macri was forced to sign a new and record US\$57bn loan programme with the IMF, which set out targets for fiscal and monetary improvement. But Macri was by this stage politically weakened. With the peso under repeated speculative attack the government missed key IMF targets. Macri's bid for re-election failed.

The incoming Fernández administration reverted to greater state control, recreating multiple fixed exchange rates, and re-imposing a series of agricultural export taxes. However, the Peronist ruling coalition (known as the Frente de Todos – FtD) was deeply divided over economic policy, with the *kirchneristas* resisting a renegotiated agreement with the IMF and failing to produce a coherent alternative strategy. The government eventually reached a new agreement with the IMF, now reduced to a US\$44.5bn package, in January 2022. Even though its terms were less severe than those of the Macri package, there was significant slippage on agreed fiscal and monetary targets, particularly in 2023. Matters were worsened by the impact of the Covid-19 pandemic (2020-21) and a record drought (2023). In a repeat of the situation four years earlier, as the October 2023 election approached, the peso was again subject to renewed speculative attack.

While there is a genuine and ongoing left-right ideological debate over who is responsible for Argentina's extended period of decline, the evidence shows that independent of political colour, all recent governments have failed to achieve sustainable growth. This could suggest that policies needed to reverse the country's decline do not necessarily fit neatly into a left-right spectrum.





Is politics now a game of three thirds?

After the country's obligatory primaries held on 13 August there are now three credible contenders for the presidency. They are Sergio Massa, the current economy minister and a centrist member of the ruling Unión Por La Patria (UP) centre-left coalition (formerly known as F+D); Patricia Bullrich, a former security minister (2015–2019) who is backed by the centre-right Juntos por el Cambio (JxC) coalition; and Javier Milei, an economist and self-designated political outsider, representing the right-wing La Libertad Avanza (LLA) party. Voting for the parties or coalitions supporting these three candidates in the primaries broke down roughly into three thirds. The LLA received 30.04% of the vote, followed by the JxC with 28.28%, and the UP with 27.2%. The gap of only three percentage points between these three group results suggested that the race for Argentina's future government remained open. But in terms of direct votes for the presidential hopefuls, Milei secured a surprise early advantage coming out in pole position with 30.04% of the votes cast, followed by Massa with 21.4% and by Bullrich with 16.98%.

The general election is due to be held on 22 October. Apart from the presidential race, voters will choose 130 of 257 seats in the Chamber of Deputies and 24 of 72 seats in the Senate. To win the presidency outright, a candidate needs to meet two conditions: to be the most voted, and to secure more than 45% of the total votes cast. First round victory is also possible if he or she wins most votes, takes between 40%–45% of the total, and ends up 10 percentage points ahead of the nearest rival. Failing these conditions means that a second-round run-off between the two most voted will be held on 19 November. The new president will be sworn in on 10 December.

For Massa a key factor is his background as an experienced mainstream politician. He has come to the fore as other Peronist factions have lost appeal. They include the left-wing populist *kirchneristas* loyal to Vice President Cristina Fernández de Kirchner, who herself served as president from 2007–2015, and the *albertistas*, followers of incumbent President Alberto Fernández, who are being blamed for the current economic meltdown. Massa accepted the job of economy minister just over a year ago (August 2022), calculating that achieving some economic wins and bringing inflation down in the 12 months prior to the election would boost his popularity. But so far there are no real wins to speak of, and inflation has increased remorselessly. Argentine voters have a reputation for turning their backs on poor-performing incumbent governments (whether of the left or of the right).

Patricia Bullrich sits on the right of *La Grieta*, the historic political fault line that runs through Argentine politics. Herself a former Peronist (she was involved in the Montoneros guerrilla movement in the 1970s), Bullrich has shifted to the right over the years and is now known for her hard-line anti-crime positions when she was security minister during the right-wing presidency of Mauricio Macri (2015–2019). She proposes escalating action against drug traffickers, and deploying the armed forces in cities like Rosario and greater Buenos Aires. She also supports new restrictive legislation on picketing and roadblocks, and a reduction in the age of criminal responsibility to 14.

Bullrich also promises to introduce a bi-monetary system (based on the peso and the US dollar), remove currency controls, cut subsidies, and to “end inflation”. If elected, she says her government would focus on developing production and employment.

Milei markets himself as a complete outsider who, unlike his rivals, is not part of the corrupt ruling caste which is complicit with Argentina's decadence. An economist and academic with little political experience Milei's sweeping proposals and radical opinions have dominated a big part of the political debate so far. He promises to completely dollarise the economy, eliminating the peso as legal tender, and to close down the central bank. He also undertakes to "take a chain saw" to the public sector, with spending cuts equivalent to 15% of GDP (he has not however given details of where they might fall). Milei has also cultivated an image as a contrarian eccentric.

It is worth noting that Argentine voters can be volatile and guarded about sharing their real intentions with opinion polling companies. Before the primaries most opinion polls ranked Bullrich first and Massa second, with Milei trailing in third place. The primaries completely reversed that order, with Milei first and Bullrich last. Polls conducted since the primaries have shown Milei achieving further gains with support rising to 35%–38% but there could be more surprises.

A three-way split in the electorate is something new in Argentina which has for years experienced a two-way split between Peronists and anti-Peronists. In other words, above and beyond the election results, the rise of Milei is highly consequential for the longer-term workings of the country's political system. Of critical importance is the current projection that none of the three main political groups will control a majority in congress. Based on voting trends in the primaries Milei's LLA could end up with 41 deputies (out of 257 in the lower house); Massa's UP would have 92 seats; and Bullrich's JxC would be the largest force with 107. All three parties or coalitions are expected to fall short of an outright majority, which requires 129 deputies or more. There is a similar situation in the senate.

Because of this lack of a clear congressional majority the next president will face two alternative political scenarios. The most negative is a prolonged congressional deadlock, which could hold up key legislation and weaken the new government. The second scenario is more positive: the president will have to build a wider coalition around a programme of basic reforms. This would be a radical change after decades of partisan "win-lose" politics.



The nightmare inbox

The next president of Argentina will take office on 10 December, just under three months from the publication of this report. On that day, he or she will be presented with what could be called a nightmare inbox. Dealing with the short term political and economic crisis will demand time, focus, and steady nerves. Yet Argentina also faces long term structural, social, and political imbalances that need to be addressed with some urgency.

What's in the inbox? Likely to be problem number one is retail inflation, which by August had reached an annual rate of 124.4%, the highest level in three decades, and was threatening to rise further before inauguration day. Problem two is an acute shortage of foreign currency which makes it difficult to pay for essential imports. Issue number three is that net foreign currency reserves held by the central bank will at the time of the handover likely be negative by around US\$10bn. Problem four is what to do with a bizarre system of over 20 centrally managed exchange rates including the 'soya dollar' and the 'Coldplay dollar' (the latter incorporates a 30% tax on booking foreign bands for local concerts). Problem five? After years of stagnation the economy is expected to shrink again by around 2% in 2023, partly due to an unprecedented drought.

Item six is that the new president will have to rapidly decide how to handle the country's often toxic relations with the IMF. Argentina has been bailed out by the IMF 22 times in the last 65 years, and most of those bailouts failed to restore economic health. Argentina owes the fund US\$44bn and has secured

financing support only to the end of December. The new president will therefore be under pressure to renegotiate an already renegotiated IMF economic programme, a course of action for which the bulk of the population will have very little enthusiasm. Problem seven is that, with existing foreign debt at around 80% of GDP, the country may be once again risking a default, which would be the tenth in its history.

There are plenty more challenges on the list. Anti-corruption measures and reform of the politicised justice system are long overdue. Politically controversial energy price subsidies need to be reviewed. The new president will be asked whether to ratify the long negotiated free trade agreement between Mercosur (the trade block formed by Argentina, Brazil, Paraguay, and Uruguay) and the European Union. Ratification will be welcomed by the farm lobby but opposed by more protectionist-minded industrialists.

In short, the new president will take office amid a deep crisis, particularly as these 'inbox problems' are all interrelated and tied into longer term issues which also need attention, such as the country's endemic budget deficits or its failure to attract sufficient long term foreign investment. A brief outbreak of looting in various provinces in August served as a reminder that the public mood is volatile and the risk of some kind of social unrest cannot be discounted. Just over 20 years ago in the (southern hemisphere) summer of 2001/2002 a combination of inflation, devaluation, default, and a freeze on dollar bank accounts (known as *el corralito*) triggered riots across the country and forced a democratically elected president to resign and be flown out of a besieged Casa Rosada (government house) by helicopter.

However, it is also true that a dire outcome to this year's political transition is by no means inevitable. Fresh from an electoral victory the new president will enjoy some degree of good will and electoral legitimacy. At least initially, public opinion is likely to support new and radical approaches to the country's recurring structural problems. Also, despite the financial and monetary crisis, a strong agricultural recovery from this year's drought could be an economic positive in 2024.

The dollarisation question

A major issue for the next president is what to do about the weakened national currency, the peso. Almost all economists acknowledge that a deep-rooted lack of confidence in the peso makes resolving almost every other issue in the inbox much more difficult. Over decades Argentines have come to associate the peso with high inflation and perpetually depreciating value against hard currencies, as well as with recurring financial crises. Anyone and everyone who has an opportunity tends to buy US dollars or euros on the black or informal market as a more reliable store of value. In fact, because of this deep distrust in the peso, Argentine citizens are estimated to hold billions of dollars which are undeclared to the tax authorities and stashed in offshore savings accounts in the US and Europe.

In Latin America, Panama, El Salvador, and Ecuador have all dollarised their economies. The next president needs to decide whether Argentina should do the same. A landmark paper² written by IMF economists in 2000 laid out some of the arguments for and against dollarisation, which remain relevant today. It identified three main advantages and three disadvantages. The first advantage is that full dollarisation eliminates the recurring currency and balance of payments crises that have bedevilled Argentina. Second, lower transaction costs and stable prices in dollar terms will enable closer integration with the global and US economies. Third, by ruling out printing domestic money to fund domestic deficits it is likely that financial institutions will be strengthened, helping create positive investment sentiment.

But the disadvantages are also significant. One is that in practical terms dollarisation will be resisted by those who see it as a loss of sovereignty; adoption may therefore be politically divisive. Secondly, dollarising countries lose seigniorage revenues (profit accruing to the monetary authority from its right to issue currency). Third, and perhaps most significantly, a dollarising country relinquishes an independent monetary and exchange-rate policy, including the ability to provide liquidity support to its banking system in an emergency.

In Argentina's specific case there are some additional considerations. One is that it will be costly

to buy back all pesos in circulation at an exchange rate that does not dramatically impoverish the population. Milei's team has suggested that the buy-back cost would be of the order of US\$40bn, but there is uncertainty over the amount and over how that money might be raised in a country which is already close to default. A combination of selling central bank assets, pension fund assets, 5G spectrum sales, and privatisation of state energy company YPF to pay the bill for dollarisation, has been proposed as a possible solution by Milei's team, but could face implementation problems.

Another point is that Argentina already has had a painful experience with partial dollarisation – in the 1990s it introduced a currency board or peg under which the peso and the US dollar were fixed one-to-one. While it initially created a valuable period of monetary stability, Argentina's inflation rate continued higher than US inflation and government budgets were not balanced, building up renewed tensions. There followed a forced and disastrous exit from what had been described as the irreversible dollar peg. The result was the catastrophic devaluation and default crisis of 2001/2002. Proponents of dollarisation tend to believe it will almost magically force politicians to become fiscally responsible but that is not necessarily the case. Dollarisation is not a miracle cure.

A group of former Latin American central bank presidents have criticised³ the dollarisation proposal as insufficient to resolve Argentina's structural problems. Former Brazilian central bank president Arminio Fraga (1999–2003) said it “sounds like a magical solution”. A group of Argentine economists wrote an open letter describing dollarisation as a “mirage” and a proposal that would entail “absurd” increases in debt, further compromising the country's weakened public finances. However, many libertarian economists deny these shortcomings and support the idea. Economist Daniel Lacalle has claimed that “opening the Argentine economy to generate reserves (dollars) is not difficult for a wealthy nation with plenty of options”. Economist Tyler Cowen describes dollarisation as “common sense”.

The next president may agree that some kind of

confidence shock is needed to rebuild destroyed trust in the currency. Dollarisation is one, but not the only way that a positive shock might be provided. A dual-currency system or more flexible version of a currency board could also provide a solution. Or the new government could adopt a managed float with inflation targeting – currently used by many of the largest Latin American economies. A credible fiscal responsibility law might also serve as a way of anchoring expectations. Whatever the policy adopted, the new president will also face an implementation challenge, that is gaining the support of a legislature where no coalition can muster a majority.



2 Berg, A. and Borensztein, E. (2000) 'Full Dollarization – The Pros and Cons', IMF



Could there be a recovery around the corner?

This paper has focused on some of the risks facing Argentina's new president over the next six months as elections are held and the new government settles in. They include hyperinflation, street protests, and possible claims of electoral fraud (although the probability of the latter is relatively low). Two of the three remaining candidates in contention for the presidency (Massa and Bullrich) are products of a discredited political establishment that for years has performed poorly. The third (Milei) wants to "take a chain saw" to that establishment but has no experience of government and could prove to be a wild card.

That said, it is worth noting that there could be a successful transition and a year of strong growth ahead, opening up opportunities for economic and political reform in the medium term. Following this year's damaging drought, the key agricultural and livestock sector is expected to rebound strongly in 2024. That could add as much as US\$20bn to the country's foreign currency reserves allowing the new president some room for manoeuvre as he or she renegotiates with the IMF and seeks to build back the country's depleted dollar holdings.

The construction of new pipelines means Argentina can continue developing the giant Vaca Muerta shale deposits in Patagonia, exporting to European governments preoccupied with finding alternatives to Russian gas. Argentina also has

strong opportunities in the global energy transition, particularly in producing lithium and other metals mined on the eastern slopes of the Andes. While gas is a 'dirty' fuel, associated with carbon emissions, it is nevertheless less dirty than oil and widely seen as a key component in a shifting energy mix. Given its need to find alternatives to Russian gas, the European Union therefore is an ideal gas export market for Argentina and a potential diplomatic ally for the new administration. Argentina is also relatively advanced in developing lithium, a key metal in the new generation of electric vehicles.

While uncertain at this stage, the prospect of a Mercosur-European Union free trade agreement, and Argentina's newly acquired membership of an enlarged BRICS group could also improve export capacity.

Finally, it is worth mentioning that despite a poor track record, some monetary stabilisation programmes in the region have succeeded. In the 1990s the Plano Real in neighbouring Brazil successfully introduced a new currency and sharply reduced the fiscal deficit and inflation. In the early 1980s Argentina experimented with its own Plan Austral, though this delivered fewer lasting improvements. The point here is that Argentina's new government will have a number of credible policy options to assist economic recovery.

3 Malinowski M. (2023) 'Argentine economists lambast dollarisation proposal as 'mirage'' Bloomberg, 10 Sep.



Conclusion

Looking forward, the key to unlocking Argentina's recovery will be political. A successful economic recovery programme will need to gain the support of congress and last a lot longer than the country's two-year political cycle (general elections are held every four years with mid-term congressional polls in between). A recovery programme will need to be backed by a cross-party political pact, something that successive governments, locked into partisan opposition, have to date failed to pursue.

There are of course no guarantees that the next president of Argentina will be a political success. In the case of the negative scenario – a president who proves ultimately unable to unwind Argentina's 'permanent crisis' – there will be some early 'tells', which will stand out during the transition period. Political recriminations between rival parties after the vote in October and in the second round (if one proves necessary) will be a warning light. Anything that indicates that politicians are continuing as in the past, to play a zero-sum game, placing their own party's interests above all else will be a cause for concern.

On the other hand, as we have suggested, there is a positive scenario. Early signs will be the emergence of meaningful negotiations between some combinations of the three main political coalitions. While these will likely start in secret, a change in tone towards a more pragmatic and cooperative stance may be detectable. Argentine politicians have often been fascinated by Spain's Pactos de la Moncloa, a series of cross-party agreements reached in 1977 and designed to stabilise inflation and unemployment during the transition to democracy. Although the situation is different (Argentina has enjoyed nearly four decades of democracy) the magnitude of the economic crisis could build a new consensus for reform.

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