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The Macroeconomy of Argentina: Problems and Solutions

Kees Benkendorfer, Alex Hsu, Thomas Malthouse, and Evian Oosthuizen

Abstract: In this paper we examine the current condition of Argentina's macroeconomy in order to make policy recommendations. We identify hyperinflation as the most significant and pressing problem facing the country. We describe a three-pronged set of monetary and fiscal policies designed to address the concerns we have identified and improve the status of the macroeconomy in Argentina. Namely, we propose (1) to fight inflation by introducing a new Argentine peso and pegging it to the US dollar at a one-to-one exchange rate, (2) to seek an agreement with the IMF to provide an emergency loan of dollars if needed, and (3) to engage in fiscal austerity to reduce the government deficit and promote long-run fiscal sustainability.

I — Introduction

Argentina has had a troubled economic history. One of the wealthiest countries in the world at the turn of the 20th century, a century of monetary and political turmoil has left the country plagued by recurring hyperinflations and recessions, worsened by rising unemployment and a chronic debt problem. A history of defaults and uncompensated takings have left relations with foreign investors and the IMF very strained and discouraged investment in the country, while a bloated public sector and high tax rates (either real or inflation-based) suppress economic growth. There is no single solution to this malaise — these woes all build on one another, sustaining and worsening Argentina's ongoing financial crisis and stymying reform.

In this paper, we will survey Argentina's monetary and political institutions and its current macroeconomic status. We will then discuss Argentina's monetary and fiscal problems in more depth, studying their recent history (primarily since the turn of the millenium) and past attempts at reform with a special focus on previous measures used to combat hyperinflation. For fiscal reforms, we also consider neighboring Latin American democracies that suffered similar problems and their attempted solutions. Finally, we propose a slate of solutions to rectify Argentina's ongoing financial difficulties and increase growth and consumer confidence, with an eye on the political and social challenges inherent in passing necessary reforms, and detail tactics to sell our reforms to the Argentine public.

I.1 — Argentine Financial Institutions

Argentine monetary policy is managed by a self-administered (i.e. independent) central bank, the Banco Central de la República Argentina (BCRA). The Argentine central bank has a four-fold mandate "to promote... monetary and financial stability, employment, and economic development with social equality" (BCRA 2012, sec. 3). The BCRA is operated by a Board with a Governor, a Deputy Governor, and 8 members. These individuals serve 6-year terms and are appointed by the President of Argentina with the approval of the Senate (sec. 7). Among the major functions of the BCRA are to regulate the financial system, to serve as a bank for the Argentine government, and implement foreign exchange policies (sec. 4). The sole right of issuing bills and coins in Argentina falls to the BCRA (sec. 30). Intriguingly, the BCRA is required to publish in advance (specifically, before each financial year) its policy objectives and plans (sec. 42).

Other governmental bodies regulate financial institutions beyond the banking sector. Securities markets and mutual funds are overseen by the National Securities Commission, and the insurance sector is overseen by the National Insurance Supervisor (Rennhack 2016).

The Argentine financial system is small and transactional, with government-operated federal, provincial, and municipal banks accounting for approximately 45% of banking activity as of 2013 (Rennhack 2016). Argentine banks keep large capital and liquidity buffers, and as a result the banking system of Argentina has been generally very stable for several years (see Rennhack 2016 and IMF 2019). Bank deposits are insured through a Deposit Insurance Fund (Rennhack 2016). Banks are the most significant players in the Argentine financial system, accounting for approximately two-thirds of all financial sector assets in 2013 (Rennhack 2016).

Bank loans in Argentina are diversified but short-term, with an average duration in 2013 of one year (Rennhack 2016). In order to meet its mandate to "promote economic development with social equality," the BCRA exerts influence over the allocation of credit through requirements on bank lending: for example, starting in 2012, the BCRA required banks with more than 1% of system deposits to lend 5% of deposits at interest rates of 15% (which was below market rates) with 3-year average maturities, and half of these loans had to be made to small and medium-sized businesses (Rennhack 2016). The main provider of long-term financing for productive projects (e.g. infrastructure) is the Sustainability Guarantee Fund (FGS), which accounted for 20% of financial assets in 2013 (Rennhack 2016). This is an arm of the Argentine Social Security Administration (ANSES) that was created in 2007.

In summary, Argentina has a small and stable financial system dominated by the Argentine government, though there is a sizeable and healthy private component. Monetary policy is managed by an independent central bank that also exerts control over the allocation of credit. Loans in general are typically made with short maturities. A significant amount of both banking assets and financial assets more broadly are controlled by the government.

I.2 — Argentine Political Institutions

Argentina is a relatively stable and competitive democratic republic, with a governmental structure closely mimicking that of the United States. Executive authority is vested in the president, who is elected through a two-round system — if the first round does not yield a clear winner with at least 45% of the vote or 40% and a 10-point lead, the top two candidates face off in the second round. The legislature is bicameral, with senators being elected by popular vote in each district, and deputies (analogous to US Representatives) being elected nationwide on a party-line proportional vote[1]. There are elections held every two years, with the President and deputies sitting for four-year terms, and senators for six.

The legislature holds the power of the purse and is ultimately responsible for taxation and public spending (although the President retains veto power over these decisions). They also oversee the BCRA, and (per the constitution) have the sole authority to mint currency and determine its value (Argentine Constitution, §75.11). This authority has been ceded to the BCRA

[1] That is—if party A wins 30% of the popular vote nationwide, they are allowed to appoint approximately 30% of deputies as they see fit.

through its charter, which was ratified by an act of congress. However, all spending and fiscal authority remains with the National Congress.

Argentine politics is dominated by Perónist parties, which are (largely) left-populist in nature. These parties earn strong support from the lower and middle classes, with promises of extensive social programs and standing up to creditors and international institutions. Since Juan Perón's election in 1946, there has been only one democratically elected non-Perónist president — Mauricio Macri, who was elected in 2015 and, having lost his re-election bid, is due to leave office on December 10, 2019. The National Congress is also dominated by various Perónist factions, with Perónist parties holding a majority of seats in both chambers Note, however, that these factions and parties are far from unified—even under a Perónist president and government, squabbles and infighting can significantly delay the passage of legislation or require extensive compromise.

Like many developing countries, Argentina faces serious issues with patronage, vote-buying, and corruption. Social programs in poor communities are often run by party operatives, with benefits contingent (either explicitly or implicitly) on support for a certain party. Public employment works similarly, with many public-sector jobs being distributed to supporters as a reward for recruiting voters and little focus on efficiency or quality in government work. In Argentine politics, a "Ñoqui" (Gnocchi) is a civil servant who only shows up to work to collect a paycheck at the end of the month (referring to the Argentine custom of eating Gnocchi on the 29th of every month). A 2015 study estimated that there were approximately 200,000 of these absentee workers on government payrolls, representing approximately 5-7% of public sector employment and costing the government approximately $20B ARS (2015), or about $1.8B USD annually (Uriel 2015). The outgoing president, Mauricio Macri, has waged a campaign against Ñoqui both as president and previously as mayor of Buenos Aires, but resistance from unions and labor groups has limited its efficacy.

Public sector employment represents approximately 18% of total employment, which is higher than the regional average of approximately 12% and in line with the OECD average of about 20%. It has also been rising in recent years, driven largely by growth in regional and municipal social services. As mentioned above, the Argentine public sector is not particularly efficient or productive, with productivity lagging significantly behind the private sector (World Bank 2018). Attempts to reform public employment or increase its efficiency (e.g. by adopting e-procurement systems or otherwise digitizing bureaucracy) have proven ineffective, due to resistance from low-skilled government employees and fears of employment cuts (OECD 2019).

Public sector spending accounts for approximately 44% of Argentina's GDP, one of the highest in the region and a figure that has sharply increased in recent years. The renationalization of Aerolineas Argentinas in 2008 and YPF (the state oil company) in 2012 under the Kirchner government (among other renationalizations) contributed to this growth, in addition to straining relations between the Argentine government and foreign investors. Given the low productivity of the Argentine public sector and persistent issues with deficits and foreign currency shortages, reducing the size of the public sector and reprivatization of certain industries may be fruitful.

I.3 — Major Industries and Exports

Argentina has a large and varied economy. The country boasts a significant agricultural production and export sector, thanks to fertile soil, as well as a diversified industrial sector —

among the major industries are manufacturing of motor vehicles and consumer durables, steel and metallurgy, and textile and chemical production ("Argentina" 2019). The country has a strong export market as well. Argentina's largest trading partner is Brazil (16.1%), followed by the United States (7.9%) and China (7.5%) (CIA 2019). This could serve as a convenient source of foreign currency.

II — Current Macroeconomic Situation

Looking at the economy more broadly, Argentina's macroeconomic situation can be summarized by four key variables: gross domestic product, unemployment rate, inflation, and interest rates. Considering these four variables gives an overarching picture of Argentina's macroeconomy and allows for a better understanding of the current issues facing Argentina. Debt, specifically debt-to-GDP, is also a factor that can be indicative of a country's stability and its ability to repay. Overall, we find that Argentina has experienced a significant economic downturn over the past couple years, coupled with increasingly high inflation. Argentina's debt has also grown very large.

II.1 — Gross Domestic Product (GDP)

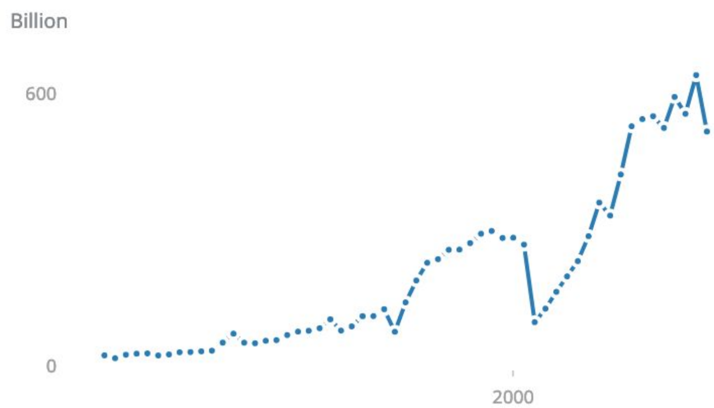

Fig. 1: GDP (in current US$) from 1968 - 2018.

(Source: World Bank, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=AR)

Argentina's GDP (see Fig. 1) has seen a near exponential rise from the mid-19th century. Economic growth has been considerably quicker in the years following 2002, as compared to most of the years before, which show relatively stagnant GDP—largely due to the stability and reforms following the appointment of Eduardo Duhalde as president following a period of domestic turmoil. A notable occurrence is the sudden recession occurring in 2002, shown through a steep decline in GDP. This year was the worst of a tumultuous period for Argentina from 1998 to 2002, referred to as the "Argentine Great Depression." In 2002 specifically, on the back of large riots and a debt default, the Currency Board of Argentina abandoned their one-to-one fixed exchange rate peg between the US dollar and the Argentine Peso (Saxton 2003). What followed was a sudden devaluation of the peso as markets adjusted to the new free floating currency, and a bout of economic decline that is also reflected in the other three macroeconomic variables. At the end of the exchange rate peg, then-President Duhalde's government announced that all US dollar denominated bank deposits would be "pesified," or converted to pesos, at a rate fixed by the government (Jacobs 2003). Since the peso's value was falling so quickly, it meant that the real wealth of a lot of people suddenly dropped.

More recently, we see GDP growth has fallen off from this period of quick growth and GDP has begun fluctuating, with a notable drop 2018.

II.2 — Unemployment

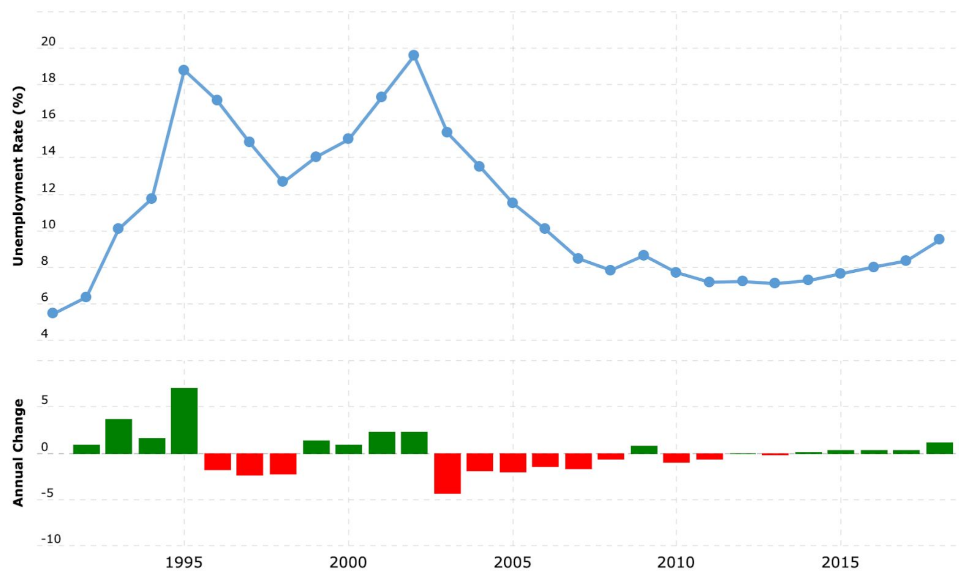

Fig. 2: Unemployment from 1991 to 2018

(Source: World Bank, https://data.worldbank.org/indicator/SL.UEM.TOTL.ZS?locations=AR)

Figure 2 shows similar changes and trends. Unemployment spikes during the Argentine Great Depression, then recovers after 2002. During the subsequent period of expansion, when GDP was growing at its fastest during the post-2002 period (see Fig. 1), unemployment drops to a recent low of 7 percent, which suggests a value for Argentina's natural rate of unemployment.

Recently, there has been an uptick in unemployment, signaling the start of another cyclical period of high unemployment. In conjunction with the recent drop in GDP discussed above, this provides some cause for concern about the health of the Argentine economy.

II.3 — Inflation

Fig. 3: Argentine consumer price index inflation from 1998 to 2019

(Source: IMF World Economic Outlook,

https://www.imf.org/external/datamapper/PCPIPCH@WEO/ARG)

Figure 3 displays the inflation rate in Argentina from 1998 – 2019. Argentina has had a history of high inflation, even before the time frame of this graph — historical values from portions of the 20th century dwarf the inflation rates of the past two decades. They recurrently suffer from bouts of hyperinflation, which in turn leads to consequences elsewhere in the economy and has historically caused recessions and debt defaults or restructurings.

The graph shows a sudden jump in inflation around the time of the 2001 crisis, reaching a peak of around 40% before quickly falling again. More recently from 2015 onwards, inflation has been increasing exponentially and is currently at a rate of 54.4% according to the IMF. This inflation volatility and sudden hyperinflation is indicative of underlying macroeconomic problems in Argentina. Moreover, this inflation decreases both wealth of creditors and money-holders in Argentina and confidence in the Argentine economy. It discourages foreign investment, inconveniences the Argentine people, and increases economic uncertainty. This is a significant problem for the Argentine economy.

II.4 — Interest Rates

Fig. 4: Leliq interest rate (%) from 1995 to 2019

(Source: https://tradingeconomics.com/argentina/interest-rate)

The Leliq interest rate measures the rate on peso denominated central bank short term notes auctioned daily known as Leliqs. This is the Argentine central bank's primary benchmark for the interest rate.

The graph shows a pattern which mirrors the inflation graph. This is because as inflation changes, the interest rate must reflect the new real value of money when considering how much interest is paid back. Furthermore, the central bank of Argentina would typically set an interest rate floor to help protect the country's currency.

II.5 — Debt and Deficits

In addition to problems with real economic variables and inflation, Argentina has a significant fiscal problem in its large sovereign debt. Argentina is no stranger to debt. Since declaring independence from Spain in 1816, Argentina has defaulted on its debt no less than eight times (Bartenstein 2019). Two of these periods occurred in the last 20 years, and there are mounting concerns that another default is imminent.

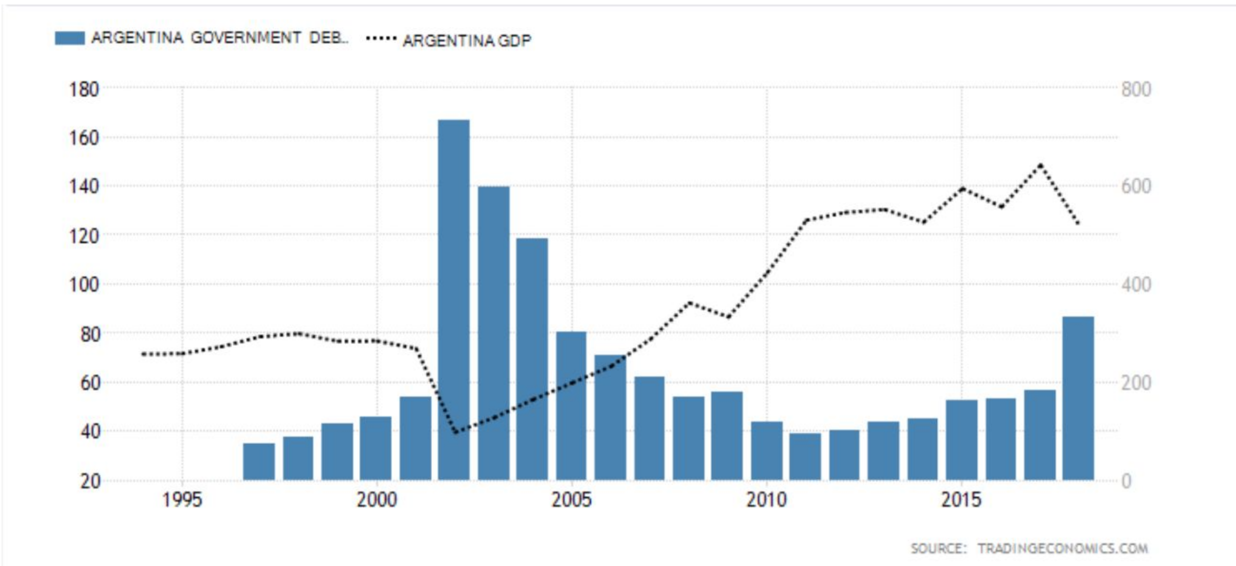

Fig. 5: Argentina Government Debt as share of GDP (bars), Argentina GDP (line), from 1994 to 2018. (Source: https://tradingeconomics.com/argentina/government-debt-to-gdp)

The largest default in the country's history occurred in 2001, amidst the ongoing financial crisis, as the government tried to stop runs on deposits by partially freezing withdrawals, as well as implementing mandatory conversion of dollar denominated assets and liabilities into pesos at asymmetric rates. Because of these schemes, the IMF ruled that Argentina was no longer meeting the conditions laid out in their aid package and withheld disbursements (IMF 2003). With all this fiscal pressure, interest payments on the $132 Billion debt that Argentina held at the time were called off by an interim president, Adolfo Rodríguez Saá. Argentina defaulted in order to fund job creation and other social programs in an attempt to stave off the recession (Krauss 2001). At the time, $95 billion dollars of the debt was in the form of bonds. This debt was restructured in negotiations that took place from 2005 to 2010. The vast majority of bondholders accepted a 70% percent discount on what they were owed, in exchange for smaller and more frequent interest payments, however a small contingent of creditors refused to accept anything less than full payment.

This steadfast group of creditors was mostly made up of American hedge funds, who came to be known as “Vulture” funds for their practice of buying sovereign debt in struggling countries, and suing for full payment. Their dispute with the Argentine government came to a head in 2014, when the US Supreme Court ruled that Argentina had to pay the holdout creditors what they were owed from 2001 first, before the country could make any further interest payments on their current debt. This presented a problem. Per a “Rights Upon Future Offers” clause in the restructuring agreement, all bondholders were entitled to the same terms of repayment, so paying full price to the holdouts would entitle the rest of the bondholders to receive the same treatment, rather than the 30% they had negotiated (Vuletin 2014). Unable to pay full price to everyone, Argentina defaulted once again. The “RUFO” clause expired in December of 2014, allowing negotiations of settlements to begin. While Argentina continued to be locked out of the international credit market, this was a decidedly milder episode than the previous one. In 2016, a settlement was finally reached, Argentina paid off the holdout creditors, and regained credit market access (Stevenson, 2016).

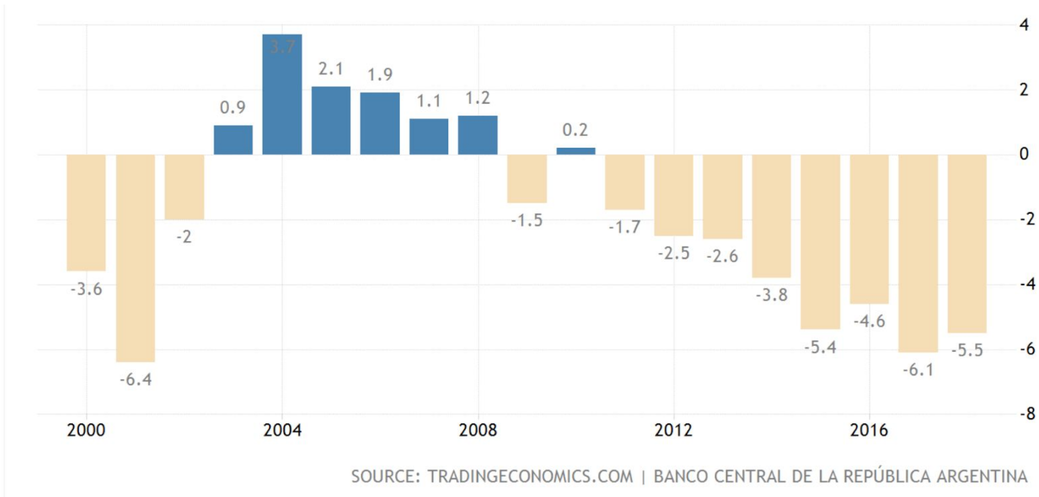

Fig. 6: Argentina Primary Balance from 2000 to 2018

(Source: https://tradingeconomics.com/argentina/government-budget)

Argentina has run a primary deficit in 12 of the last 18 years, with the deficits typically being significantly larger than the surpluses. While the trend overall has been increasingly large primary deficits, Argentina's budget draft for 2019 predicts a primary surplus of 1% of GDP. A survey of economists conducted by Reuters estimates that the year will in fact end on a deficit, around 0.7% of GDP (Misculin 2019).

At present, Argentina holds roughly 447 billion dollars of debt or 86.2% of GDP (Trading Economics 2019). While the mood was generally improving for investors in the wake of the 2016 debt settlement, uncertainty around the results of the most recent presidential election, in particular populist Alberto Fernandez's victory, is raising concern that the country will attempt to restructure its debt once again, in the face of looming interest payments that are due in 2020. Fernandez has been vocal about his disdain for the IMF, and his promises to put money in the pockets of Argentinians is a potential threat to the current fiscal austerity regime.

As of August (before the election) traders of credit default swaps on Argentine debts were already factoring in a 75% chance of default within 5 years (Maki 2019). This concern is reflected by rating agencies. Moody's and Standard & Poor currently give Argentina's credit a "substantial risk" rating, while Fitch and DBRS have branded it "extremely speculative" (Trading Economics 2019).

III — Major Problems

Argentina's primary macroeconomic problem is hyperinflation. As discussed above, the inflation rate is currently 54.4%. Such high levels of inflation are unsustainable, mainly because inflation erodes the real value of money, since the same amount of pesos can buy less goods and services. Inflation is closely related to the value of the peso in the international market, since the peso's real value declines with respect to other currencies, such as the US dollar. This change can be seen by looking at the historical exchange rate between the Argentine peso and USD.

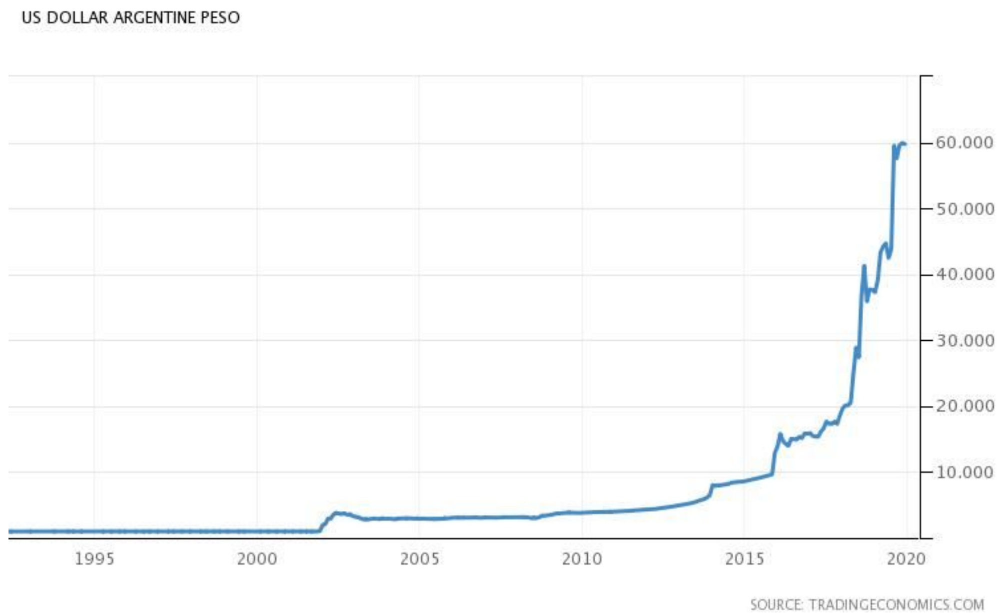

Fig. 7: United States Dollar/Argentine Peso exchange rate

(Source: https://tradingeconomics.com/argentina/currency)

Figure 7 shows the USD/ARS exchange rate from 1992 to the present skyrocketing in the past three years, reaching a level of around 60 peso per USD, which is where it hovers now.

Another factor that exacerbates the devaluation of the peso is the public's lack of confidence in the currency. The expectation of high inflation erodes confidence in the currency, and leads to a rush to withdraw pesos and exchange it into a more stable currency, typically USD. This puts further downward pressure on the peso, and leads to bank runs that stress the financial system.

The other pressing problem is Argentina's apparent growing debt. Argentina's past years of running fiscal deficits, though may no longer continue as mentioned before, have built up considerable debt, alongside other loans they must repay, such as the recent large IMF loan.

Eichengreen *et al.* have suggested that theoretically debt can be sustainably rolled over and maintained if interest rates are less than the growth rate, but that is not applicable here given Argentina's extremely high interest rates (Eichengreen *et al.* 2019). Because of Argentina's volatile inflation rates and history of default, foreign credit markets demand a high risk premium and do not trust the Argentine government to repay the full value of its loans. Alongside the recent economic downturn, this increases the risk of a sovereign default, which would have strongly adverse effects on output and unemployment within Argentina.

IV — Proposed Solutions

To tackle the inflation problem, we propose a program of exchange-rate-based stabilization (ERBS). This has been demonstrated to be an effective and relatively painless method for ending hyperinflationary episodes (Fischer *et al.* 2002). The idea is that using a foreign exchange rate as a nominal anchor can decrease inflation expectations and make the money supply endogenous, thereby avoiding contractionary shocks to the money supply that would result under the use of alternative disinflationary tactics. Indeed, Fischer *et al.* show that ERBS can sometimes have expansionary short-term effects on macroeconomic variables.

The ERBS strategy for disinflation has been used in Argentina in the past. In 1991, the Argentine Currency Board was established to oversee a fixed one-to-one exchange rate with the US dollar. If it had been an orthodox currency board, this dollar peso parity should have been enforced by reserves; the currency board would have had to hold foreign reserves equal to at least as much as every peso in circulation. This meant every peso should have been tangibly backed by a dollar that could be exchanged for if the holder wishes to do so. However in actuality, the central bank held under 100% of liabilities in foreign assets, and instead made up for the gap with Argentine government bonds denominated in foreign currency (Hank and Schuler 2002). This was an extreme version of a pegged exchange rate where the rate is completely fixed, and hence, given the stability of the dollar, the peso was also stabilized and inflation would decrease. This method did not have similar concerns of credibility as many policies implemented by the central bank, since it was very easily enforceable and verifiable. The currency board succeeded in what it set out to do: control inflation. It should be noted that Hank and Schuler repeatedly emphasize the distinction between Argentina's currency board and what they call an orthodox currency board. The biggest difference is that Argentina's currency board acted similarly to a central bank, where they participated in domestic monetary policy (Hank and Schuler 2002). Nevertheless, the system was effective for approximately a decade.

Ultimately, however, the Currency Board failed. The reasons, as with any financial crisis, are complicated — Eichengreen (2002) provides a nice description of the events leading to the failure — but the essentials are as follows. Pegging the peso to the dollar under the Currency Board system introduced competitiveness problems in international markets as the value of the dollar fluctuated. At the same time, the Argentine government was engaged in fiscal austerity, trying to alleviate debt it had previously built up. These combined to create a recession and, thanks to a loss of confidence in the stability of the Argentine economy, a financial crisis in 2001 (Eichengreen 2002). Because the exchange rate was pegged to the dollar, Argentina could not print money to alleviate the recession and provide liquidity to the financial system and thus could only respond to the crisis by acquiring dollars. While the IMF provided assistance early in the crisis, it ceased its assistance after determining that Argentina had not met its fiscal goals, as we discussed above. With protests in the streets, the executive leadership of the government resigned and the exchange rate peg was abandoned (Eichengreen 2002). In the end, the Currency Board failed because economic instability resulted in a financial crisis that could not be alleviated because of the exchange rate peg — Argentina could not acquire enough dollars.

This provides a stark historical warning for the path forward. Though ERBS is effective for reducing hyperinflation, which we have identified as the primary problem currently facing Argentina, a pegged exchange rate is risky. It can introduce economic vulnerabilities and tie the government's hands in responding to an economic downturn and/or financial crisis. In the long run, Argentina should therefore aim towards a stable sovereign currency. But in the meantime, once inflation has been managed, these risks need to be mitigated. An external source of emergency funding should be secured in order that Argentina be able to respond adequately to a crisis. And the Argentine government should move towards fiscal sustainability both to increase confidence in the Argentine economy, to facilitate the securement of external emergency funding, and to limit future debt-based vulnerabilities.

We therefore propose a three-pronged solution to the current inflationary problems facing Argentina. (1) Argentina should establish a new peso to be held at a fixed one-to-one exchange rate against the US dollar — to enable the transition to the new currency, Argentina should institute a 6 month period during old pesos can be exchanged for new at a rate of 60 to 1 (roughly the current peso's current exchange rate with the dollar). (2) In order to avoid future liquidity crunches because of the fixed exchange rate, Argentina should seek an agreement with the IMF to provide an emergency loan of dollars if necessary — that is, Argentina should establish an agreement that the IMF will act as a lender of last resort if the need arises.[2] And (3) in order to promote long-run fiscal sustainability and facilitate the establishment of such an agreement, Argentina should engage in fiscal austerity measures to reduce the government deficit and, therefore, future debt obligations. These points are discussed in greater detail below.

IV.1 — Fixed Exchange Rate

When choosing to peg the new peso to a foreign currency, the first question that arises is which currency to peg to. One seeks a stably inflating and widely-exchanged currency that Argentina can acquire in reasonable quantities. Among the most major global currencies are the US dollar, the Euro, and the Japanese yen. For the previous few decades, Japan has experienced extremely low inflation at best and long periods of deflation at worst. Thus, the yen does not appear a viable choice for the currency peg. As discussed in Sec. I.4, United States is Argentina's second-largest trading partner, and while Eurozone countries trade more in bulk with Argentina, the European Union has experienced a number of crises (e.g. the Greek debt crisis and Brexit) in the past decade that suggest the potential for monetary instability in the future. The US dollar is therefore the most appealing option.

We recommend establishing a new currency to be traded at one-to-one parity with the dollar primarily to signal the Argentine government's commitment to low inflation. The hope is that the visible change of a novel currency will help to decrease inflation expectations — even simple models of inflation like the dynamic inconsistency model demonstrate the importance of decreasing inflation expectations when a central bank wishes to reduce inflation (White 1999).

[2] This has the added benefit of creating a political scapegoat for fiscal austerity measures. The IMF can be blamed for austerity in order to alleviate pressure on the incumbent government and free their hands somewhat to implement what fiscal measures they see fit.

The choice of the particular value of the exchange rate is fairly arbitrary, as the nominal exchange rate should not matter if it is fixed. A one-to-one exchange rate seems the most reasonable in the absence of reasons to choose a different value.

It might be argued that the exchange rate should be allowed to 'crawl' — that is, that the exchange rate should be allowed to change over time in order to enable Argentina to have higher inflation than the United States. Yet the nominal value of inflation should not matter if it is constant and predictable. While one might claim that increased inflation could reduce Argentina's debt burden by allowing the country to 'inflate away' the debt, it is important to notice that rational creditors will anticipate the inflation under a publically known crawl rate and increase interest rates on the debt accordingly, thus negating any benefit. At the same time, providing a mechanism for the exchange rate to change might generate fears that the Argentine central bank could alter the exchange rate in the future — this could increase inflation expectations and make disinflation more difficult for the central bank.[3] A fixed exchange rate will help to signal Argentina's commitment to low inflation in the future.

It remains to determine how the exchange rate peg will be enforced. In order to encourage confidence in the peg, we propose to re-implement a system of peso-dollar parity backed by one-to-one dollar reserves. Argentines should be able to withdraw dollars from the bank for every peso they have deposited as this will demonstrate the stability of the new currency and the government's commitment to low inflation. This will, however, create the same potential liquidity issues that were encountered in the 2001 financial crisis. We propose to mitigate these

[3] The same issue would arise (perhaps more strongly) if the crawl rate were kept secret by the central bank.

risks by attempting to reach an agreement with the IMF to have access to an emergency supply of dollars should the need arise.

IV.2 — IMF Loan Agreement

In recent decades, the IMF has often acted as a lender of last resort for governments — the organization even intervened in the early days of the 2001 Argentine financial crisis. Yet when the IMF ceased providing aid to Argentina back then, the Argentine economy collapsed and the exchange rate peg of the day had to be abandoned.

Thus, we must ensure that Argentina has access to an adequate supply of dollars. One way to do this would be to require the central bank to hold more reserves than there are pesos in circulation. And indeed, this would be an effective way to create a liquidity buffer to prevent financial breakdown. The BCRA should therefore be encouraged to hold excess dollar reserves. But there always remains a possibility that the government uses up all of its reserves. To prevent a fatal liquidity crunch in this situation, a lender last resort must be secured. The IMF has acted as such a creditor repeatedly in recent decades, including to Argentina. We therefore propose that an agreement be sought that the IMF act as a lender of last resort to Argentina should the need arise.

But how do we convince the IMF to agree to such an advance agreement — essentially a line of credit? The IMF halted its support in 2001 when it was determined that Argentina was not meeting the fiscal requirements necessary for its support (Eichengreen 2002). That is, Argentina's deteriorating fiscal situation in 2001 was what prevented Argentina from securing IMF funds. Argentina's best chance at establishing an emergency loan agreement from the IMF is therefore to engage in fiscal restructuring now in order to promote fiscal stability in the future — a clear commitment to continued fiscal stability will provide a strong case for support.

IV.3 — Fiscal Austerity

Aiming for fiscal stability will have broader positive consequences as well. Ultimately, Argentina's debt problem and recurring inflations stem from unsustainable spending. Argentine politicians face enormous pressure to fund and expand a wide range of benefit programs and public sector work, while high inequality and ineffective tax collection practices leave them unable or unwilling to raise tax revenues to pay for spending. The difficulties facing Argentina's public sector have already been established, but its tax regime faces similar structural problems, with the two reinforcing each other. Corporate and individual tax evasion is widespread: over 60% of taxpayers believed to evade income and value-add taxes and the government collects approximately 54% of what it would be expected to collect if evasion were nonexistent (Bergman, 2003). Argentines often cite low faith in government and widespread corruption as reasons for nonpayment (McGee, 2008), as well as a widespread sense that paying taxes is a "sucker's game." Penalties for noncompliance are low to nonexistent, with the revenue service (the Administración Federal de Ingresos Públicos, or AFIP) suffering from the same weaknesses facing other government agencies. Because of the difficulty inherent in collecting traditional taxes, the inflation tax has been an attractive option for policymakers hoping to raise revenues.

As discussed by Alesina *et al.*, austerity enacted via cuts in spending tend to be far less damaging than tax hikes (Alesina *et al.* 2019). This is especially true when the spending in question is not going towards growth-promoting endeavors such as infrastructure, education, or the rule of law. We propose to enact aggressive spending cuts, reprivatizing the industries nationalized under the Kirchner administration and replacing the bulk of the country's social programs and their army of administrators with a negative income tax rate for the lowest tax brackets (which we discuss below) to reduce administrative overhead while lessening impact to the poor.

In addition to lowering the government's primary deficit, privatizing various state-owned companies (most notably, Aerolíneas Argentinas and YPF) would increase Argentina's foreign currency reserves at a critical time and improve relations with foreign investors. When these companies were privatized between 2008 and 2014, the government did not fully compensate investors, leading to a case in the US Supreme Court requiring the Argentinian government to pay up. Coupled with a commitment to avoid renationalization in the future, this would make Argentina more amenable to foreign investment and potentially increase growth.

Reform of the tax code and increasing compliance offers the dual possibility of increasing revenues and easing the political cost of cuts to social programs. Specifically, we suggest that Argentina consider negative marginal rates for the lowest tax brackets, replacing the existing hodgepodge of transfer payments and social programs with a single scheme administered by the AFIP. By eliminating the vast bureaucracy administering the current welfare and social programs and replacing it with a rules-based tax code, the cost of providing these benefits should drop considerably, without having severe impacts on the people they purport to serve. We also suggest that the National Congress write and pass a unified tax code, combining the statutes governing various taxes (most notably, the VAT and income taxes) to remove contradictions and make tax evasion more difficult; and give the AFIP more resources and leeway to investigate and prosecute tax fraud. Chile serves as a valuable model here—after undergoing similar difficulties with inflation and debt throughout the 70s and 80s, they pursued an aggressive tax reform to bring compliance rates up, and now has evasion rates similar to the United States (Bergman, 2003). An aggressive push to increase tax compliance may also make these changes more politically palatable — the tax reforms can be framed as fighting inequality by providing additional income to the poor while ensuring the well-off pay their fair share, a message that is likely to play well with the Perónist base.

IV.4 — Political Considerations

The changes we propose in this paper are unlikely to be popular. Ending inflation inherently has a contractionary effect, while aggressive cuts in public spending will lower total output unless replaced one-for-one with private investment — all this as Argentina is already facing a recession. Argentine voters have a long history of punishing reform-minded politicians who threaten social programs and spending, or even mobilizing in the street if economic conditions become dire enough.

Still, the time to act is now. A new left-wing administration takes office on December 10, and will have enough political capital and trust with the Perónist base to push these reforms through. The next election is two years away, and the next presidential election four. Our proposed reforms are ultimately intended to increase growth and prosperity, and by making reforms now, these benefits should start becoming apparent before the next election.

V — Summary and Conclusion

Argentina has the capacity to have a strong economy with significant, sustained growth. It has a diverse industrial sector, strong export market, and stable financial system. But the country has long been plagued by periods of high inflation; a new inflationary period has begun over the past several years. Combined with the recent economic downturn and high sovereign debt, Argentina's economy is struggling under the burdens of uncertainty and the country runs the risk of default.

The core of the problem is the recent bout of hyperinflation. The last inflation rate reported by the IMF was a rate of 54.4% in 2019, and inflation has been growing exponentially since the mid 2010s. This has degraded confidence in the Argentine economy and sovereign credit, limiting the country's access to foreign credit markets. Disinflation must be performed to avoid potential economic disaster.

In order to accomplish this, we have proposed a three-point monetary and fiscal policy plan for Argentina to use as it moves forward. First, disinflation should be achieved by introducing a new peso and tying it to the US dollar at a one-to-one exchange rate. This will signal, in a highly visible way, the Argentine's government commitment to keep inflation low, and thereby will help restore confidence in the Argentine economy. Second, in order to avoid the future liquidity problems that could emerge from a pegged exchange rate, the Argentine central bank should be encouraged to hold excess dollar reserves and an agreement should be sought with the IMF, by which the IMF would agree to act as a lender of last resort for the nation of Argentina should the need arise. Third, in order to approach sustainable levels of debt in the future and appeal to the IMF, the Argentine government should signal its commitment to fiscal sustainability by engaging in an extensive program of fiscal austerity and reforms. Aggressive cuts to public spending programs should be performed, state-owned companies should be privatized, and the tax code should be reformed to facilitate and encourage compliance. This will have the added benefit of eliminating the need for seigniorage that may, in part, have pressured the government to inflate.

This program will not be politically popular. Indeed, it will be extremely difficult to sell to the Argentine people. But when the new Perónist government takes office on December 10, they should use their political capital to engage in these much-needed reforms. Indeed, regime change is the optimal time to act, as the economy may have the opportunity to adjust to the reforms and recover before the next elections. The new government should not allow short-term political gains to prevent them from undertaking what is necessary for long-term economic prosperity. They should not resile from this difficult but essential program of reforms. Our hope is that we have laid the theoretical groundwork for the path forward.

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