Ekonomi-tek Volume / Cilt: 6 No: 2 May / Mayıs 2017, 13-24

ARGENTINA'S LONG HISTORY OF (ECONOMIC) UNCERTAINTY

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Abstract

Instability and uncertainty have been the hallmark of Argentina's political economy throughout its history. Volatility in GDP, inflation, the exchange rate, the terms of trade, and capital flows characterizes the burden that Argentines—ordinary citizens, investors, and policymakers—have had to endure for as long as anyone can remember. The internal design of monetary, financial, and capital-market institutions has made possible a 13-zero depletion of the currency and several confiscations of bank deposits. Argentine fiscal institutions have long been partial to short-term, pro-cyclical planning. Self-centered discretion has been the rule, with complete disregard for the huge costs created by uncertainty. Is there any way for Argentina to rid itself of this disastrous tendency and put itself on a path to sustainable growth and improved welfare?

JEL Codes: E63

Keywords: Argentina, uncertainty, fiscal deficits, institutions

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1. Introduction

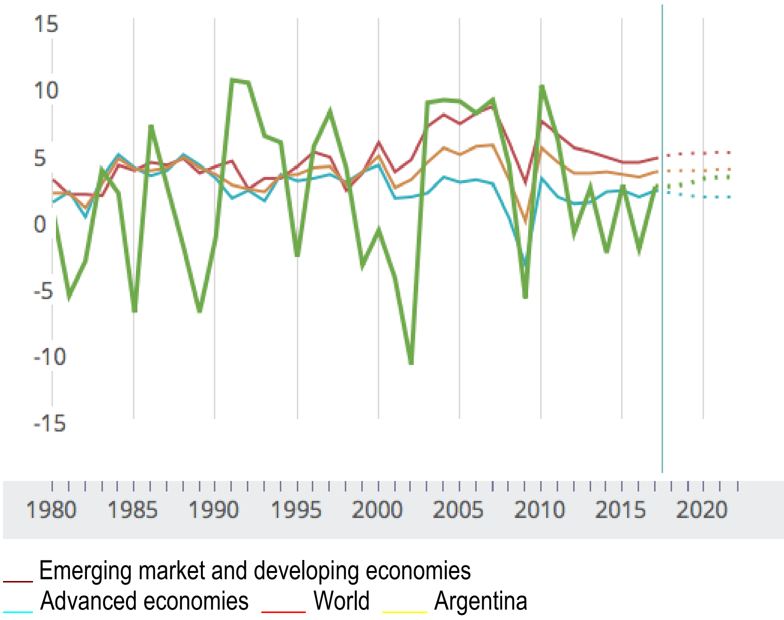
Argentina is a land of paradoxes and contrasts: prosperity coexists with poverty, booms abruptly alternate with busts. But one of the most puzzling riddles is how until the 1920s–just a century ago–Argentina managed to be among the top ten economies in the world, ahead of France, Germany, and Italy. Its income per capita was more than 90% of the average of the richest economies; nowadays, that percentage is less than 45% (*The Economist*, Feb. 2014). Argentina was rich, but, over 100 years, somehow it fell off a cliff, lowering its people's living standards down a very steep ladder. In the process, the population has since acquired a certain attitude that has become part of the culture, or DNA: an awareness (or expectation) of constant volatility and uncertainty.

Volatility in GDP, inflation, the exchange rate, the terms of trade, and capital flows characterizes the burden that Argentines—ordinary citizens, investors, and policymakers—have had to endure for as long as anyone can remember. Compared to the world as a whole and to other groupings (both advanced and developing economies), Argentina's real GDP shows *more extreme variability*, marked by frequent boom and bust phenomena (see Graph 1, based on IMF Datamapper 2017). Also, having a history of devastating hyperinflations, Argentina is nowadays struggling to exit the Losers' Circle (countries whose *inflation rates are higher than 25%*; Argentina (26.9%), Sudan (26.9%), Angola (30.9%), Libya (32.8%), Congo (41.7%), South Sudan (182.2%), and Venezuela (652.7%)). See Graph 2, based on IMF Datamapper 2017.

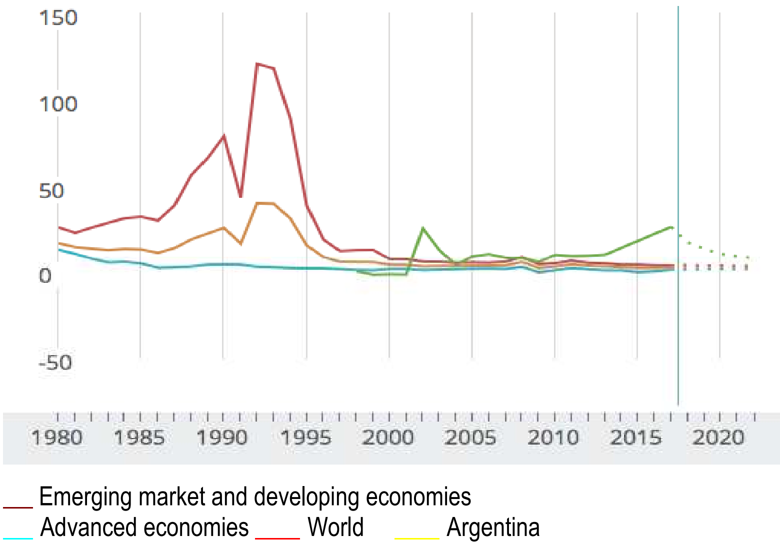
Is there any way for Argentina to rid itself of this disastrous tendency and put itself on a path to sustainable growth and improved welfare? Mainstream macroeconomic theory argues that a sustainable increase in per capita income requires macroeconomic stability. At the same time, microeconomic theory stresses that a sustainable rise in per capita income results from investment, both in physical and human capital.

Both arguments –macroeconomic stability and investment– have a common prerequisite: a low degree of uncertainty. Without certainty, there is widespread refusal to extend long-term contracts; reluctance to plan and put money, effort, or time into making profits in the long term. Societies lacking a fair degree of certainty and respect for the rule of law are doomed to short-termism and its corrosive after-effects on economic growth, welfare, and progress.

Graph 1. Real GDP Growth, Annual Percentage Change



Graph 2. Inflation; Average Consumer Prices Annual Percentage Change



Source: IMF, Datamapper, 2017

2. Measures of Uncertainty

As Jurado et al. (2015) point out, at a general level, uncertainty is typically defined as the conditional volatility of a disturbance that is unforecastable from the perspective of economic agents. In partial- equilibrium settings, increases in uncertainty can depress hiring, investment, or consumption if agents are subject to fixed costs or partial irreversibilities (a “real options” effect), if agents are risk averse (a “precautionary savings” effect), or if financial constraints tighten in response (a “financial frictions” effect). In general-equilibrium settings, many of these mechanisms continue to imply a role for time-varying uncertainty, although some may also require additional frictions to generate the same effects.

Dimensions of economic uncertainty affect (i) a country and its macroeconomic performance, (ii) a country and its institutions, (iii) a country and its political/electoral outcomes and systems, and (iv) a country and its relationship to the outside world. Macroeconomic and structural/institutional uncertainties are within the scope of governments. Political/electoral issues also matter, especially in countries where the political cycle is somehow diluted and all years are electoral. Therefore, it is up to a government to bring about a healthy macroeconomic situation with predictable market movements and ironclad observation of the rule of law; only then will it be in a position to withstand external shocks from the world economy.

Even though holistically measuring uncertainty under different scenarios or across episodes is still regarded as a challenge in the economic literature, three proxies are available to outline Argentina’s sorry experience with massive uncertainty over the years. These uncertainty metrics include:

a) *High inflation rates.* This phenomenon encompasses not only continuous rises in the prices of goods and services in the economy but also the accompanying volatility. Not knowing the future direction of inflation (i.e., will it get even worse?) hobbles economic decision making. Argentina’s rotten reputation in this area includes hyperinflations (with monthly inflation rates as high as 197%, in July 1989) and a tradition of tinkering with published statistics in order to put the best (and a totally false) face on unpleasant economic and financial facts.

b) Expensive black-market premium. This premium is the difference between the value of the local currency on the illegal market and its official exchange rate in relation to the US dollar. For instance, in January 17, 2013, the official exchange rate for the Argentine peso was AR$4.95 per US$1, while on the black market, one US dollar was yielding AR$7.50; a 50% markup.

c) Elevated country-risk premium. The Emerging Markets Bonds Index (EMBI) is a leading indicator of country credit risk. JP Morgan calculates it as the difference in the interest rate paid on dollar-denominated bonds, issued by a national government, and US Treasury Bonds, which are considered *free* of risk.

The greater the perceived risk, the higher the interest paid and the wider the spread between these bonds and US Treasury bonds. In other words, the lucrative returns coming from a risky bond is really compensation for running the risk of default by the issuer. Table 1 shows the last 18 years of Argentina's country-risk premium. Two noteworthy points emerge: the quantum of the maximum country-risk premium Argentina has been saddled with, and the variability of the index.

Table 1. Argentina in the 21st Century Country Risk Premium, Data as of Nov. 1, 2017

President Presidential period	# days with country risk premium data	minimum CRP (a)	maximum CRP (b)	Rank (a)-(b)
Mauricio Macri 10 Dec 2015 – ongoing	490	342 (day #483)	569 (day #103)	227
Cristina Fernández de Kirchner (2nd mandate) 10 Dec 2011 – 10 Dec 2015	1034	466 (day #1022)	1348 (day #250)	882
Cristina Fernández de Kirchner (1st mandate) 10 Dec 2007 – 10 Dec 2011	1033	357 (day #1)	1965 (day #242)	1,608
Néstor Kirchner 25 May 2003 - 10 Dec 2007	1179	185 (day #955)	6769 (day #530)	6,584
Eduardo Duhalde 2 Jan 2002 - 25 May 2003	359	3943 (day #33)	7222 (day #156)	3,279
4 peronist mandates in 10 days 21 Dec 2001 – 31 Dec 2001	7	4404 (day #7)	5495 (day #3)	1,091
Fernado De la Rúa 10 Dec 1999 – 20 Dec 2001	**523**	509 (day #17)	4449 **(day #523)**	3,940

Source: Ámbito Financiero database. EMBI+, elaborated by JP Morgan. Note: A measure of 100 basis points means that the government in question would be paying one percentage point (1%) over the yield of risk-free bonds (U.S. Treasury Bills).

As Ávila (2011a) states, the country-risk premium captures not only the relative price volatility within an economy but also the likelihood of a long list of events that hinder capital accumulation in that country: sovereign default, confiscation of assets, nationalizations, bank runs, bank lock-outs, substantial currency devaluations, endemic inflation, prohibitions on exports, and the like. One estimate of the welfare cost of Argentine risk for the period 1976-2006 (Ávila (2011b)) puts it at 20% of GDP, a figure several times larger than the welfare cost of any conventional distortion.

Since independence in 1816, Argentina has defaulted on its sovereign debt eight times. In 1890, when it could not honor its foreign debt, the merchant bank Barings Bank suffered a near-collapse as a result. Much later, in 2001, the Argentine government had the dubious honor of being the world's biggest defaulter—$100 billion. The negative publicity that followed the decision of international creditors to hold out for better terms from the 2005 debt restructuring effort turned Argentina into a pariah state in international capital markets.

As of 2017, however, after a settlement was reached with the holdouts the year before, Argentina is back in the global bond markets, putting out huge debt issues, even one with a 100-year term. Even so, whenever an even minor jitter roils the financial markets over the soundness of Argentine debt, the uncertainty that goes along with the credit analysis delivers a body blow to the overall Argentine economy: the population again subconsciously is ready to expect the worst, having had a century of economic mismanagement, where governments in trouble with international creditors have ofter resorted to confiscatory measures imposed on their citizens to pay the foreign piper. Argentines' resigned expectation of this is part of that special DNA that sets these people apart as a *rara avis*.

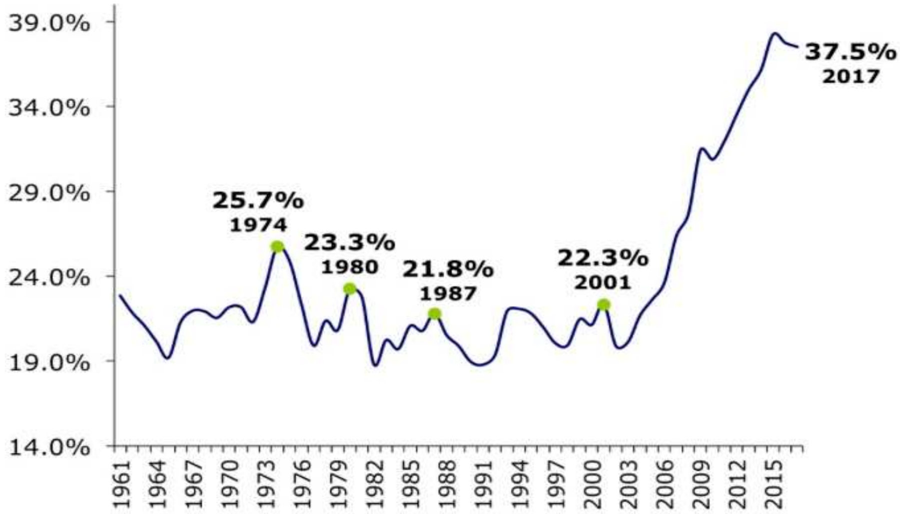
3. Uncertainty and Fiscal Deficits

Fiscal deficits are a foremost source of macroeconomic uncertainty in Argentina. The persistence of towering deficits, financed either by debt issues or inflation of the currency (not to mention other unscrupulous practices like confiscating private assets—such as bank savings accounts—that totally disregard the rule of law), stokes even greater inflation. In response, investment projects are postponed or canceled, reducing the capital stock per worker, restraining technical progress, and reducing per capita income.

Argentina's public spending is one for the record books; in 2017, on a consolidated basis, the primary expenditures of the national government, provinces and municipalities amounted to 37.5% of GDP; see Graph 3.

The Argentine state bulks even larger than those of most of the developed countries. But unlike those countries, Argentina's supply of quality public goods (education, health, security, justice, infrastructure) is still very low. Instead, over the last decade, public finances in the country have been characterized by populism, unprofessional management of public resources, and pervasive corruption.

Graph 3. Primary Expenditure Consolidated Public Sector, as Percentage of GDP



Source: Perspectiv@s based on MECON and INDEC

Acemoğlu et al. (2003) present a very thorough and sound discussion on the sources of volatility in Argentina and argue that the main driver of macroeconomic uncertainty there is not *bad* policies (such as excessive government spending, high inflation, and overvalued exchange rates) *per se*, but, rather, underlying institutional weaknesses. Weak institutions (including political institutions that do not constrain politicians and political elites, ineffective enforcement of property rights for investors, widespread corruption, and a high degree of political instability) foster the adoption of distortionary macroeconomic policies, which, in turn, produce macroeconomic uncertainty.

The repetitive nature of unsustainable and unwise macroeconomic policies in Argentina stems from an underlying pattern of weak institutions; the existence of this "skeleton" under the surface is what makes the unconscionable periodic redistributions of income feasible and even politically rational.

4. Into the Argentine DNA

Argentina has suffered a countless number of economic crises. Besides hyperinflations and international credit defaults (both to the greatest extent possible), national governments have become accustomed to pursuing policies that put property rights at risk and undermine the rule of law in the process. All such experiences have imprinted themselves on the Argentine DNA, making the people more aware than their counterparts in other countries.

There are many economic textbooks that spell out precisely the types of economic measures that, if implemented by a government, will lower the disposable income of the population, as a whole or limited to a subgroup or groups within the society not in favor. Usually, other groups, having more power, will be the beneficiaries of such favoritism preferences. Not receiving as much attention to date are those harmful economic policies that violate the institutional order or take control of private assets, resulting in a shrinking of disposable income. The purpose of this paper is to fill that gap.

As mentioned, the very anatomy of Argentine monetary, financial, and capital - market institutions has paved the way for a hollowing out of the value of the national currency (a total of 13 zeroes have been lopped off it to make it manageable) and the confiscation of the citizens' bank deposits on several occasions.

Table 2. Monetary Designations in Argentina Zero Removals

Monetary designation	**1 unit in current (2017) pesos**	**Zeroes**	**In force for**
Peso (current) Decree 2128/91	1	Removes 4 zeroes from Austral	**25 years and counting** (01/01/**1992** – nowadays)
Austral Decree 1096/85	0.0001	Removes 3 zeroes from Peso Argentino	**6 years** (15/06/**1985** -31/12/1991)
Peso Argentino Law 22.707	0.0000001	Removes 4 zeroes from Peso Ley	**2 years** (01/06/**1983** - 14/06/1985)
Peso Ley Law 18,188	0.00000000001	Removes 2 zeroes from PMN	**13 years** (01/01/**1970** - 31/05/1983)
Peso Moneda Nacional Law 3,871	0.0000000000001		**88 years** (05/11/**1881** - 31/12/1969)

Source: Author's compilation

Over the last century, Argentina has revamped its currency designation four times (peso moneda nacional, peso ley, peso argentino, austral, and peso). Table 2 presents each currency title with its date of introduction and the number of zeroes taken off its predecessor. It also presents the equivalent of one unit of each currency with respect to the current peso.

At least five episodes of general explicit confiscation of Argentines' money took place over 55 years. Interestingly, Modigliani's life-cycle consumption theory does not even consider the possibility of such a scenario, assuming that all such *institutional details* were discounted. Table 3 summarizes the list of confiscatory episodes.

Table 3. Explicit Confiscations in Argentina: 20th and 21st Centuries Five Concrete Episodes

Date	**Episode**
April 1964	*Pesoification of deposits*
October 1983	*Frozen deposits for 2 months*
January 1990	*7-day deposits for 10-year bonds*
January 2002	*Asymmetric pesoification of deposits*
December 2008	*Nationalization of pension funds*

Source: Author's compilation

In April 1964, Argentina was overwhelmed by an external debt that it was unable to service or redeem. "Back then, like now, the government took a drastic decision," writes *La Nación* (2002), one of the few newspapers that actually kept records going back 50 years that chronicled the episode. It was during Arturo Illia's presidency (October 1963–June1966) that all saving deposits denominated in dollars were pesofied (i.e., mandatorily converted into pesos). The amount impounded was some $200 million (equivalent to $1.6 billion today), and the banks were in no position to return the dollars to their rightful owners. Savers had only one month to sell their dollars.

In October 1983, only three weeks before the first presidential elections (after years of dictatorship), the Argentine government decreed that all foreign-currency deposits would henceforth be unavailable—at least until December 4th. Maturities were extended for 60 days, and deposits did accrue interest during the time period. Only foreign officials and diplomats were exempted from this measure.

A prominent Spanish daily (*El País*, October 7, 1983) stated that "a high official from the Palacio de Hacienda denied that the government was prepared to break into banks' safe-deposit boxes, where much of the black market of US dollars has been stashed away. However, over the last two days, there have been scenes of panic in the financial center of Buenos Aires, with long queues of depositors seeking information or emptying their safe-deposit boxes.

The “parallel” dollar—formerly the only store of value in the Argentine economy—is now technically valueless and is reportedly declining in price. In turn, the prices of imported goods, which had been skyrocketing, have been dynamited. The flight of the American currency into private residences or abroad (thanks to the porous borders with Bolivia and Paraguay) can be described as a “dollar stampede.”

Again, all bets were on the government’s applying these foreign currencies taken from the citizenry toward its most urgent international obligations: payments for strategic imports and service of foreign debts. In effect, what had happened was a private-to-public-transfer *solution*.

In January 1990, as part of the Bonex Plan, and with a backdrop of accelerating inflation, the government, having required the exchange of short-term dollar-denominated debt for 20-year versions in December 1989, then forced the swapping of 7-day accounts for 10-year BONEX. The 7-day (*plazo fijo*) holders were allowed to withdraw only around $500 from their accounts, with the remainder being transformed (by government order) into 10-year dollar-denominated bonds (BONEX Series 89).

The dollar immediately collapsed on the foreign-exchange market. The new minimum term for deposits was lengthened to 90 days. This confiscation of 7-day accounts amounted to a $3 billion removal of liquid assets from the economy. Further arm-twisted refinancings occurred in October 1990, when $8 billion owed to contractors was suddenly frozen and then converted into 10-year negotiable indexed government bonds.

In January 2002. In December 2001, Argentina restricted bank withdrawals in a last-ditch attempt to save the imploding banking system ahead of an expected sovereign default in international markets. These restrictions, referred to as the “*corralito,*” allowed only withdrawals between $1,000 and $1,200 per month. In January 2002, in the wake of the resignation of Fernando de la Rúa and his replacement by Eduardo Duhalde as the new president, the government was worried about impending personal and corporate bankruptcies on a huge scale, To counteract this threat, the authorities imposed an “asymmetric pesoification,” thereby devaluing bank deposits to a rate of AR$1.4:US$1 while keeping bank debt at AR$1:US$1; this created disproportionate losses for savers and profits for debtors. The move also left banks in a fragile state, so the government had to step in and compensate them with some $8 billion in sovereign bonds.

In December 2008, Argentina nationalized the country's private pension plans (AFJPs): nearly $30 billion in private pension funds was transferred to government custody in order "to protect retirees from falling stock and bond prices as the global financial crisis continues." This infusion of funds shored up state coffers, giving it the chance of heading off a fiscal crisis in 2009, when the government might be struggling to make good on billions of dollars in debt payments (*The New York Times*, 2008)

Argentina remains the worst offender in the small group of countries that have helped themselves to their citizens' pension assets to pay various obligations, whether domestic or international; other culprits are Hungary (2010), Poland (2013), Portugal (2011), Bulgaria (2014), and Russia (2014).

5. Conclusions

As della Paolera and Taylor (2001) claim, it is only by examining the relationship between institutional structure, policy choices, and economic conditions that we can begin to offer an explanation for Argentina's puzzling decline from its Golden Age at the turn of the 20th century. It was then one of the richest countries in the world, but its potential went to waste over the many years following that time under the pall of a constant incoherence in economic policies that became standard.

This is a sad story that serves as a cautionary tale for the developing world today, where many governments are grappling with the challenges of economic reform. Argentine economic history dramatically demonstrates that prosperity in incomes and prosperity in institutions are two very different things. A failure in the second can be the undoing of the first.

The persistent nature of economic crises and government expropriations in Argentina, and the fact that the same macroeconomic policies are continually resorted to, only to be followed by inevitable collapse, could well justify a despairing attitude.

However, Argentina now has a unique opportunity to turn itself around and leave behind those institutions built merely on quick and clientelist redistribution. A determination to create strong state institutions that are free of political conflict, inefficient redistribution, and utter predation will go a long way toward restoring the economic stability and prosperity that Argentines once knew.

With a sustainable growth rate and an upward welfare path, Argentina could consign to its past the memory of weak institutions that worsened competition and fanned uncertainty, weakening markets' ability to work, create, invest, and produce. The special Argentine DNA is already a parameter to be reckoned with, but new government elites should take their responsibilities to heart and ensure a healthy and thriving economy—at long last.

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