During his first press conference, Argentina’s Minister of the Economy Jorge Remes Lenicov was asked whether, in light of the country’s inflationary history, the recent 40% devaluation of the peso had any chance of success. Without hesitation the minister referred to a historical precedent. Although he was very young, the minister said, he still remembered that in 1967 a 40% devaluation was highly successful; it did not generate inflation and the value of the peso stabilized rapidly. What the Minister failed to say, however, is that in 1967 the exchange rate realignment was complemented by a drastic reduction in import tariffs, a severe fiscal retrenchment, and an extremely austere wage rate policy. As a result of this comprehensive package, put together by Minister Adalbert Krieger Vasena, the economy recovered quickly, and by 1969 GDP growth was a healthy 8.5%.

Unfortunately, the news coming from Buenos Aires suggest that this time around things will not be as rosy as in 1967. For starters, there doesn't seem to be a comprehensive plan for re-igniting growth. Worse yet, everything indicates that many of the policies being implemented will severely increase distortions and will hurt growth prospects.

Sustained economic recovery will have to come from increases in productivity in the private sector. This will require breaking a trend that started in the mid-1990s, when as a result of incomplete reforms and a rapidly growing public sector debt, productivity growth turned negative. Compare this with the case of neighboring Chile, a country that continued to consolidate market reforms throughout the decade: during the 1990s productivity growth contributed, year after year, almost 3 percentage points to Chile’s GDP growth.

As almost every one agrees, re-establishing a minimal credit market is a fundamental step in a pro-growth agenda. Since ex-minister Cavallo froze
deposits in December, credit has completely disappeared, greatly hurting business transactions at every level. In order to lift the cloud of uncertainty that has crippled financial transactions, the new authorities need to recognize rapidly two painful realities: first, banks are bankrupt and need to be recapitalized. This, in turn, should be done by the private sector – including foreign shareholders – and not by the government. Second, the authorities should announce that dollar-denominated deposits will remain frozen for a long time. The reason for this is simple: Argentina does not have the foreign exchange to honor the $46 billion dollars of deposits currently held hostage in the banking system. Holders of dollar denominated deposits should be given two options: either to transform their deposits into pesos at a low exchange rate now (1.2 to 1.3 pesos per dollar), or to transform them into long term dollar-denominated securities.

Avoiding an inflationary outburst is also a must. This requires a realistic and austere budget for 2002 – there is already talk of expenditure cuts in excess of $8 billion --, an implementing a credible monetary policy. In order to achieve the latter, the Central Bank should regain the independence it lost when, last May, President de la Rua dismissed able Central Bank Governor Pedro Pou for refusing to tinker with monetary policy. Mr. Pou should be re-instated immediately as Central Bank governor. This would not only remedy a major injustice, but it will also go a long way towards assuring the public and the market that a cold-headed and reasonable monetary policy will be followed.

The new authorities should stay away from protectionism temptations. Unfortunately, the opposite seems to be the case. New minister of production and former chief lobbyist for the domestic industrial sector, José de Mendiguren has already stated that the new government will “protect” local industry and will strictly enforce a policy that requires the public sector to purchase, even at higher prices, locally produced goods. Moreover, the former Governor of Buenos Aires and new Minister of Foreign Affairs, Carlos Ruckauf, has made it clear that his main goal is to strengthen the ties with Brazil and Mercosur. This is a bad idea. Mercosur has not been good to Argentina. By integrating itself with Brazil, Argentina has imported Brazil’s instability, its rather weak institutions and its
historical protectionism. It is not a coincidence that Argentina and Brazil are two of the most closed economies in the whole world. Argentina should seize this opportunity to abandon, once and for all, Mercosur and to truly open itself to the international economy. This will allow it to enjoy the acceleration in productivity growth that comes with greater international competition.

Finally, Argentina needs to implement a deep reform that would modernize labor relations, help reduce unemployment and contribute to the productive recovery. Unfortunately, the opposite appears to be happening, as the administration has indicated that it will repeal the partial and timid labor reform enacted by President de la Rua in 2000. A recent study by Nobel Laureate James Heckman and Carmen Pages from the Inter-American Development Bank shows that the Argentine labor market is extremely rigid – indeed more significantly more inflexible than in neighboring Brazil and than most western European countries.

If a policy along these lines is implemented Argentina will be able to recover growth rapidly. If, however, the current populist rhetoric takes hold, it will be difficult to disagree with Oscar Wilde’s character Sir Robert Chiltern, who in the play An Ideal Husband states, with great conviction: “This Argentine scheme is a commonplace…swindle.”