

The argentina economic crisis economics essay

[Economics](#)



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Rizvi- 12BSP1155Ankit Vora- 12BSP0171CONTENTS1)History2)Argentina
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History

Argentina possesses definite comparative advantages in agriculture, as the country is endowed with a vast amount of highly fertile land. Beginning in the 1930s, however, the Argentina economy deteriorated notably. The single most important factor in this decline has been political instability since 1930, when a military junta took power, ending seven decades of civilian constitutional government. In macroeconomic terms, Argentina was one of the most stable and conservative countries until the Great Depression, after which it turned into one of the most unstable. Successive governments from the 1930s to the 1970s pursued a strategy of import substitution to achieve industrial self-sufficiency, but the government's encouragement of industrial growth diverted investment from agricultural production, which fell dramatically. The era of import substitution ended in 1976, but the same time growing government spending, large wage increases and inefficient production created a chronic inflation that rose through the 1980s. The measures enacted in 1976 also produced a huge foreign debt by the late 1980s, which became equivalent to three-fourths of the GNP.

1810 Independence

After Argentina became independent in 1810, an era in which commerce was controlled by a small group of peninsular merchants came to an end.

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The Primera Junta, the first government established after the 1810 May Revolution, undertook a protectionist policy until their fall from government. The government of Martín Rodríguez (1820–1824) and his minister Bernardino Rivadavia, then Las Heras and finally Rivadavia himself as the first president of Argentina from 1826 to 1827, developed an economic plan deemed as "The happy experience". This plan increased the British influence in the national politics. It was based on five main pillars: complete free trade and no protectionist policies against British imports, finance with a central bank managed by British investors, absolute control of the port of Buenos Aires as the sole source of income from national customs, British exploitation of the national natural resources, and an Unitarist national organization centered in Buenos Aires. The exports of gold, allowed by the free trade policies, soon depleted the national reserves. This posed a great problem, as gold was the medium of exchange of the local economy. Carlos Pellegrini, laid the foundations for a return to stability and growth after the restoration of convertibility in 1899. He also reformed the banking sector in ways that were to restore stability in the medium term. Rapid growth rates soon returned: in the period 1903–1913, GDP increased at an annual rate of 7.7%, and industry grew even faster, jumping by 9.6%.

The Great Depression

The Great Depression had a comparatively mild effect on Argentina, the unemployment rate never went above 10%, and the country largely recovered by 1935. However, the Depression permanently halted its economic expansion. This led to devaluation of the peso. The devaluation of

the peso increased the competitiveness of its exports and protected domestic production. Argentina saw the value of its exports drop from \$1,537 million in 1929 to \$561 million in 1932, but this was by no means the most severe downturn in the region.

Argentina economic crisis (1999–2002)

The Argentina economic crisis (1999–2002) was a major downturn in Argentina's economy. It began in 1999 with a decrease of real Gross Domestic Product (GDP). The crisis caused the fall of the government, default on the country's foreign debt, widespread unemployment, riots, the rise of alternative currencies and the end of the peso's fixed exchange rate to the US dollar. By 2002 GDP growth had returned, surprising economists and the business media. As of 2012, the default had not been completely resolved, although the government had repaid its IMF loans in full.

1990s

After a second bout of hyperinflation, Domingo Cavallo was appointed Minister of the Economy in late 1990. In 1991, he fixed the value of Argentina currency at A10, 000 per U. S. dollar. Austral could be freely converted to dollars at banks. To secure this "convertibility" the Central Bank of Argentina had to keep its U. S. dollar foreign exchange reserves at the same level as the cash in circulation. The convertibility law reduced inflation sharply and thereafter preserved the value of the currency. This raised the quality of life for many citizens who could again afford to travel abroad, buy imported goods or ask for credit in dollars at traditional interest rates. The fixed exchange rate reduced the cost of imports, which produced a flight of dollars from the country, as well as the

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progressive loss of industrial infrastructure and employment. Government spending remained too high and corruption was rampant. Argentina's public debt grew enormously during the 1990s without showing that it could service the debt. The International Monetary Fund kept lending money to Argentina and extending its payment schedules. Massive tax evasion and money laundering contributed to the movement of funds toward offshore banks. The influx of foreign currency provided by the privatisation of state companies had ended. After 1999, Argentina exports were harmed by the devaluation of the Brazilian real and the dollar. A considerable international revaluation of the dollar directly weakened the peso relative to Argentina's trading partners: Brazil (30% of total trade flows) and the Euro area (23% of total trade flows). In 1999, Argentina's GDP dropped 4% and the country entered a three-year long recession. Economic stability became economic stagnation (even deflation at times) and the economic measures taken did nothing to avert it. Devaluing the peso by abandoning the exchange peg was considered political suicide and a recipe for economic disaster. By the end of the century, complementary currencies had emerged. While the provinces had always issued complementary currency in the form of bonds and drafts to manage shortages of cash, the scale of such borrowing reached unprecedented levels during this period. This led to their being called "quasi-currencies". The strongest of them was Buenos Aires's Patacón. The national government issued its own quasi-currency—the LECOP. In a 2001 interview, journalist Peter Katel identified three factors, converging at "the worst possible time", to explain why the Argentinian economy unraveled: The fixed exchange rate between Argentina peso and the US dollar (created at the start of the 1990s by the Economy Minister at <https://assignbuster.com/the-argentina-economic-crisis-economics-essay/>

the time, Domingo Cavallo). The large amounts of borrowing by former Argentina president, Carlos Menem. An increase in debt due to reduced tax revenues.

Rates, riots, resignations and default

Since the early 1990s, when the recession began, the national deficit widened to 2.5% of GDP in 1999 and its external debt surpassed 50% of GDP. Seeing these levels as excessive, the IMF advised the government to balance its budget by implementing austerity measures to sustain investor confidence. GDP growth projections proved to be overly optimistic (instead of growing, real GDP shrank 0.8%), and lagging tax receipts prompted the government to freeze spending and cut retirement benefits again in November 2000. In early November, Standard & Poor's placed Argentina on a credit watch, and a treasury bill auction required paying 16% interest (up from 9% in July); this was the second highest rate of any country in South America at the time. In July 2001 the government instituted an unpopular across-the-board pay cut of up to 13% to all civil servants and an equivalent cut to government pension benefits—triggering nationwide strikes, and, starting in August, it paid salaries of the highest-paid employees in I. O. U. s instead of money. The unemployment rate rose to 16.4% in August 2001 up from a 14.7% a month earlier, and it reached 20% by December. The crisis intensified when, on 5 December 2001, the IMF refused to release a US\$1.3 billion tranche of its loan, citing the failure of the Argentinian government to reach previously agreed-upon budget deficit targets, and demanded further budget cuts, amounting to 10% of the federal budget. On 4 December, Argentinian bond yields stood at 34% over U. S. treasury

bonds, and, by 11 December, the spread jumped to 42%. By the end of November 2001, people began withdrawing large sums of dollars from their bank accounts, turning pesos into dollars and sending them abroad, causing a bank run. On 2 December 2001 the government enacted measures, informally known as the *corralito*, that effectively froze all bank accounts for twelve months, allowing for only minor sums of cash to be withdrawn, initially \$250 a week.

End of fixed exchange rate

After much deliberation, in January 2002 Duhalde abandoned the peso-dollar parity that had been in place for ten years. In a matter of days, the peso lost a large part of its value in the unregulated market. A provisional "official" exchange rate was set at 1.4 pesos per dollar. In addition to the *corralito*, the Ministry of Economy dictated the *pesificación*, by which all bank accounts denominated in dollars would be converted to pesos at an official rate. This measure angered most savings holders and attempts were made to declare it unconstitutional. After a few months, the exchange rate was left to float more or less freely. The peso further depreciated, which prompted increased inflation (since Argentina depended heavily on imports, and had no means to replace them locally at the time). Inflation and unemployment worsened during 2002. By that time the exchange rate had reached nearly 4 pesos per dollar, while the accumulated inflation since the devaluation was about 80%; considerably less than predicted by most orthodox economists. The quality of life of the average Argentina was lowered proportionally; many businesses closed or went bankrupt, many imported products became virtually inaccessible, and salaries were left as they were before the crisis.

Immediate effects

Aerolíneas Argentinas was one of the most affected Argentina companies, canceling all international flights for various days in 2002. The airline came close to bankruptcy, but survived. Several thousand newly homeless and jobless Argentinas found work as cartoneros, or cardboard collectors. A 2003 estimated 30, 000 to 40, 000 people scavenged the streets for cardboard to sell to recycling plants. Such desperate measures were common given the unemployment rate of nearly 25%. Argentina agricultural products were rejected in some international markets, for fear they might arrive damaged by the chaos. The United States Department of Agriculture put restrictions on Argentina food and drug exports.

Recovery

The economic outlook was completely different from that of the 1990s; the devalued peso made Argentina exports cheap and competitive abroad and discouraged imports. In addition, the high price of soy in the international market produced massive amounts of foreign currency (with China becoming a major buyer of Argentina's soy products). The government encouraged import substitution and accessible credit for businesses, staged an aggressive plan to improve tax collection, and allocated large sums for social welfare, while controlling expenditure in other fields. The peso slowly rose, reaching a 3-to-1 rate to the dollar. Agricultural exports grew and tourism returned. The central bank started rebuilding its dollar reserves. By December 2005, foreign currency reserves had reached US\$28 billion (they were later reduced by the payment of the full debt to the IMF in January 2006). The downside of this reserve accumulation strategy is that

the dollars had to be bought with freshly issued pesos, which risked inflation. The central bank sterilized its purchases by selling Treasury letters. In this way the exchange rate stabilized near 3: 1. The currency exchange issue was complicated by two mutually opposing factors: a sharp increase in imports since 2004 (which raised the demand for dollars), and the return of foreign investment (which brought fresh currency from abroad) after the successful restructuring of about three quarters of the external debt. The government set up controls and restrictions aimed at keeping short-term speculative investment from destabilizing financial markets. Argentina's recovery suffered a minor setback in 2004 when rising industrial demand caused a short-lived energy crisis. Argentina managed to return to growth: GDP jumped 8. 8% in 2003, 9. 0% in 2004, 9. 2% in 2005, 8. 5% in 2006 and 8. 7% in 2007. Though wages averaged a 17% annual increase from 2002-2008(jumping 25% in the year to May 2008), inflation ate away at these increases: 12. 5% in 2005; 10% in 2006; nearly 15% in 2007 and over 20% during 2008. While unemployment has been considerably reduced (it hovered around 8. 5% after 2006), Argentina has so far failed to reach an equitable distribution of income (the wealthiest 10% of the population receives 31 times more income than the poorest 10%). This level of inequality compares favorably to levels in most of Latin America.

Effects on wealth distribution

Although GDP grew consistently and quickly after 2003, it only reached the levels of 1998 (the last year before the recession) in late 2004. Other macroeconomic indicators followed suit. A study by Equis, an independent counseling organization, found out that two measures of economic

inequality, the Gini coefficient and the wealth gap between the 10% poorest and the 10% richest among the population, grew continuously since 2001, and decreased for the first time in March 2005. Poverty in Argentina

Date of measurement

Extreme poverty

Under poverty

line

May 200111. 6%35. 9%October 200113. 6%38. 3%May 200224. 8%53.

0%October 200227. 5%57. 5%May 200326. 3%54. 7%2nd sem 200320.

5%47. 8%1st sem 200417. 0%44. 3%2nd sem 200415. 0%40. 2%1st sem

200513. 6%38. 5%2nd sem 200512. 2%33. 8%1st sem 200611. 2%31.

4%2nd sem 20068. 7%26. 4%2nd sem 20075. 9%20. 6%1st sem 20085.

1%17. 8%2nd sem 20084. 4%15. 3%

The table on the left shows statistics of poverty in Argentina, in percent of the population. The first column shows the date of the measurement (note that the method and time changed in 2003; poverty is now measured each semester). Extreme poverty is here defined as not having enough money to eat properly. The poverty line is set higher: it is the minimum income needed for basic needs including food, clothing, shelter, and studies.

Debt restructuring

When the default was declared in 2002, foreign investment stopped and capital flow ceased almost completely. The Argentina government faced severe challenges trying to refinance its debt. The government reached an agreement in 2005 by which 76% of the defaulted bonds were exchanged for others, with a nominal value of 25–35% of the original and at longer terms. In 2008, President announced she was studying a reopening of the negotiations to gain agreement from the remaining 24% of the debt.

Criticism of the IMF

The International Monetary Fund accepted no discounts in its part of the Argentina debt. Some payments were refinanced or postponed on agreement. However, IMF authorities at times expressed harsh criticism of the discounts and actively lobbied for the private creditors. In a speech before the United Nations General Assembly on September 21, 2004, President Kirchner said that " An urgent, tough, and structural redesign of the International Monetary Fund is needed, to prevent crises and help in [providing] solutions". Implicitly referencing the fact that the intent of the original Bretton Woods system was to encourage economic development, Kirchner warned that the IMF today must " change that direction, which took it from being a lender for development to a creditor demanding privileges". In 2005, turned its primary surplus into an actual surplus, Argentina began paying the IMF on schedule, with the intention of regaining financial independence. On December 15, 2005, following a similar action by Brazil, President Kirchner suddenly announced that Argentina would pay the whole debt to the IMF. The debt payments, totaling 9. 810 billion USD, were

previously scheduled as installments until 2008. Argentina paid it with the central bank's foreign currency reserves. The payment was made on January 6, 2006.

Sectors of GDP

Agriculture

Argentina is one of the world's major agricultural producers, ranking among the top producers and, in most of the following, exporters of beef, citrus fruit, grapes, honey, maize, sorghum, soybeans, squash, sunflower seeds, wheat, and yerba mate. Agriculture accounted for 9% of GDP in 2010, and around one fifth of all exports (not including processed food and feed, which are another third). Soy and its byproducts, mainly animal feed and vegetable oils, are major export commodities along with cereals, beef, leather and dairy. Biodiesel, however, has become one of the fastest growing agro-industrial activities. Fruits and vegetables exports: apples, pears, oranges and other citrus, grapes, etc. Major Crops include Cotton, tobacco, sugarcane, Chile peppers, etc. Yerba mate tea, tomatoes and peaches are grown for domestic consumption. Organic farming is growing in Argentina, and the nearly 3 million hectares (7.5 million acres) of organic cultivation is second only to Australia. Argentina is the world's fifth-largest wine producer, and fine wine production has taken major leaps in quality. Argentina fisheries bring in about a million tons of catch annually, and are centered around Argentina hake which makes up 50% of the catch; Pollock, squid, and centolla crab are also widely harvested. Forestry has long history in every Argentina region, apart from the pampas, accounting for almost 14 million m³ of roundwood harvests.

Eucalyptus, pine, and elm (for cellulose) are also grown, mainly for domestic furniture, as well as paper products (1.5 million tons). Fisheries and logging each account for 2% of exports.

Natural resources

Mining is a growing industry, increasing from 2% of GDP in 1980 to nearly 4% today. Coal, Metals and minerals mined include borate, copper, lead, magnesium, sulfur, tungsten, uranium, zinc, silver, and gold. Metal ore exports soared in 2004, and reached over US\$ 3 billion in 2010. Around 35 million m³ each of petroleum and petroleum fuels are produced, as well as 50 billion m³ of natural gas, making the nation self-sufficient in these staples, and generating around 10% of exports.

Industry

Manufacturing is the largest single sector in the nation's economy (19% of GDP), and is well-integrated into Argentina agriculture, with half the nation's industrial exports being agricultural in nature. Leading sectors by production value are: Food processing and beverages; motor vehicles and auto parts; refinery products, and biodiesel; chemicals and pharmaceuticals; steel and aluminum; and industrial and farm machinery; electronics and home appliances. The country's auto industry produced 829,000 motor vehicles in 2011, and exported 507,000 (mainly to Brazil, which in turn exported a somewhat larger number to Argentina). Beverages are another significant sector, and Argentina has long been among the top five wine producing countries in the world; beer overtook wine production in 2000. Other manufactured goods include:

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glass and cement; plastics and tires; lumber products; textiles; tobacco products; recording and print media; furniture; apparel and leather. Most manufacturing is organized around 280 industrial parks, with another 190 slated to open during 2012. The production of computers, laptops, and servers grew by 160% in 2011, to nearly 3.4 million units, and covered two-thirds of local demand. Another important rubric historically dominated by imports - farm machinery - will likewise mainly be manufactured domestically by 2014. Construction permits nationwide covered nearly 19 million m² (205 million ft²) in 2008. The construction sector accounts for over 5% of GDP, and two-thirds of the construction was for residential buildings. Argentina electric output totaled over 122 billion Kwh in 2009. This was generated in large part through well developed natural gas and hydroelectric resources. Nuclear energy is also of high importance, and the country is one of the largest producers and exporters, alongside Canada and Russia of cobalt-60, a radioactive isotope widely used in cancer therapy.

Services

The service sector is the largest contributor to total GDP, accounting for over 60%. Argentina enjoys a diversified service sector, which includes well-developed social, corporate, financial, insurance, real estate, transport, communication services, and tourism. The telecommunications sector include: mobile telephony, with 77% of the population having access to mobile phones; Internet (over 27 million users, or two thirds of the population); and broadband services (accounting for nearly all the 10 million accounts). Regular telephone services, with 9.5 million lines, and mail services are robust. Exports and imports of services were US\$14 billion each

in 2011. Business Process Outsourcing became the leading Argentina service export, and reached US\$3 billion. Advertising revenues from contracts abroad were estimated at over US\$1. 2 billion. Tourism is increasingly important and provided 8% of economic output in 2008; over 80% of tourism sector activity is domestic.

Banking

Argentina banking, whose deposits exceeded US\$110 billion in January 2012, developed around public sector banks, but is now dominated by the private sector. The private sector banks account for most of the 80 active institutions (over 4, 000 branches) and holds nearly 60% of deposits and loans, and as many foreign-owned banks as local ones operate in the country. The largest bank in Argentina by far, however, has long been the public Banco de la Nación Argentina. Not to be confused with the Central Bank, this institution now accounts for about a fourth of the total deposits and a seventh of its loan portfolio. The banks largely lent US dollars and took deposits in Argentina pesos, and when the peso lost most of its value in early 2002, many borrowers again found themselves hard pressed to keep up. Delinquencies tripled to about 37%. Credit in Argentina is still relatively tight. Lending has been increasing 40% a year since 2004, and delinquencies are down to less than 2%. Still, credit outstanding to the private sector is, in real terms, slightly below its 1998 peak, and as a percent of GDP (around 15%), quite low by international standards. The prime rate, which had hovered around 10% in the 1990s, hit 67% in 2002. Although it returned to normal levels quickly, inflation, and more recently, global instability, have been affecting it again. The prime rate was over 20% for much of 2009, and

17% in the first half of 2010. Partly a function of this and past instability, Argentines have historically held more deposits overseas than domestically. The estimated US\$156 billion in overseas accounts and investment exceeded the domestic monetary base (M3) by nearly US\$20 billion in 2011.

Infrastructure

Argentina's transport infrastructure is relatively advanced. There are over 230, 000 km (144, 000 mi) of roads (not including private rural roads) of which 72, 000 km (45, 000 mi) are paved, and 2, 643 kilometers (1, 642 mi) are expressways, many of which are privatized toll ways. The railway network has a total length of 37, 856 kilometers (23, 523 mi). Inaugurated in 1913, the Buenos Aires Metro was the first subway system built in Latin America and the Southern Hemisphere. No longer the most extensive in South America, its 60 kilometers (37 mi) of track carry nearly a million passengers daily. Argentina has around 11, 000 km (6, 835 mi) of navigable waterways, and these carry more cargo than do the country's freight railways. Aerolíneas Argentinas is the country's main airline, providing both extensive domestic and international service. LADE is a military-run commercial airline that flies extensive domestic services.

Foreign trade

Argentina exports are fairly well diversified. However, although agricultural raw materials were over 20% of the total exports in 2011, agricultural goods including processed foods still account for over 50% of exports. Soy products alone (soybeans, vegetable oil) account for almost one fourth of the total. Cereals, mostly maize and wheat, which were Argentina's leading export during much of the twentieth century, make up less than one tenth now.

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Industrial goods today account for over a third of Argentina exports. Motor vehicles and auto parts are the leading industrial export, and over 12% of the total merchandise exports. Chemicals, steel, aluminum, machinery, and plastics account for most of the remaining industrial exports. A net energy importer until 1987, Argentina's fuel exports began increasing rapidly in the early 1990s and today account for about an eighth of the total. Refined fuels make up about half. Argentina imports have historically been dominated by the need for industrial and technological supplies, machinery, and parts. Consumer goods including motor vehicles make up most of the rest.

Foreign investment

Foreign direct investment in Argentina is divided nearly evenly between manufacturing (36%), natural resources (34%), and services (30%). The chemical and plastics sector (10%) and the automotive sector (6%) lead foreign investment in local manufacturing; oil and gas (22%) and mining (5%), in natural resources; telecommunications (6%), finance (5%), and retail trade (4%), in services.[86] Spain was the leading source of foreign direct investment in Argentina, in 2009; the U. S. was the second leading source. Investments from the Netherlands, Brazil, Chile, and Canada have also been significant. Several bilateral agreements play an important role in promoting U. S. private investment. Argentina has an Overseas Private Investment Corporation (OPIC) agreement and an active program with the U. S. Export-Import Bank. Under the 1994 U. S.-Argentina Bilateral Investment Treaty, U. S. investors enjoy national treatment in all sectors except shipbuilding, fishing, nuclear-power generation, and uranium production. The treaty allows for international arbitration of investment disputes.

Central Bank of Argentina

Central Bank of Argentina

Banco Central de la República Argentina

Banco Central de la República Argentina. jpg

Headquarters

Reconquista 266, Buenos Aires

Established

May 28, 1935

President

Mercedes Marcó del Pont

Central bank of

Argentina

Currency

Argentina pesoThe Central Bank of Argentina (Spanish: Banco Central de la República Argentina, BCRA) is the central bank of Argentina. Established by six Acts of Congress enacted on May 28, 1935, the bank replaced

Argentina's Currency board, which had been in operation since 1899.

Normally subordinate to the Economy Ministry in matters of policy, the Central Bank took a more prominent role during the Latin American debt crisis when, in April 1980, it enacted Circular 1050. This measure, enacted to shield the financial sector from the cost of receiving payments in suddenly devalued pesos, bankrupted thousands of homeowners and businesses by indexing mortgages to the value of the US dollar locally, which rose

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around fifteen fold by July 1982. During the years of Convertibility Law, which established a 1: 1 fixed exchange rate between the Argentina peso and the United States dollar on April 1, 1991, the BCRA was mainly in charge of keeping foreign currency reserves in synch with the monetary base. Since the repeal of the Convertibility Law in January 2002, the devaluation and depreciation of the peso and the end of the economic crisis, its role has been the accumulation of reserves in order to gain a measure of control of the exchange rate. The BCRA buys dollars from the market to neutralize the large surplus of the foreign trade balance and keep the official exchange rate at internationally competitive levels for Argentina exports and import substitution. Near the end of 2005, President Néstor Kirchner announced the payment of Argentina's public debt with the International Monetary Fund in a single, anticipated disbursement. The payment was effected on January 3, 2006, employing about US\$9. 8 billion from BCRA reserves. This decreased the amount of reserves by one third, but did not cause adverse monetary effects, save from an increased reliance on the local bond market, which requires somewhat higher interest rates. The BCRA continues to intervene in the exchange market, usually buying dollars, though occasionally selling small amounts (for example, reacting to rumors of a possible increase of the Federal Reserve's reference rate, which caused a minor spike in the dollar's value. The exchange rate was maintained relatively undervalued, prompted by the BCRA's market intervention as a buyer. The official exchange rate, which had oscillated around 3 Argentina pesos per US dollar since early 2003, was adversely impacted by the international, 2008 financial crisis, and weakened to nearly 4 pesos per dollar by the first half of 2010.

Argentina Currency Board

The Argentina Currency Board pegged the Argentina peso to the U. S. dollar between 1991 and 2002 in an attempt to eliminate hyperinflation and stimulate economic growth. While it initially met with considerable success, the board's actions ultimately failed. In contrast to what most people think, this peg actually did not exist, except only in the first years of the plan. From then on, the government never needed to use the foreign exchange reserves of the country in the maintenance of the peg, except when the recession and the massive bank withdrawals started in 2000. For most of the period between 1975 and 1990, Argentina experienced hyperinflation (averaging 325% a year), poor or negative GDP growth, a severe lack of confidence in the national government and the Central Bank, and low levels of capital investment. After eight currency crises since the early 1970s, inflation peaked in 1989, reaching 5, 000% that year. To a large extent, the main reason behind this long period of hyperinflation was unsustainable growth of the money supply to finance the large fiscal deficits maintained by successive governments. Driven by rising tax evasion and losses among state enterprises, the total public fiscal deficit reached 10% of GDP in 1983. Another reason for the instability of the Argentina currency was the fragility of domestic financial institutions. The Argentina banking crisis of 1990 underlined this point, as the Central Bank moved to confiscate the deposits of commercial banks to overcome a liquidity crunch, exchanging certain types of time deposits for BONEX bonds. In April 1991, Menem reverted the country's policies according to ideas of Washington Consensus to what was later to be called economic neoliberalism. This system involved a program of massive privatization and

labor deregulation laws, which encouraged foreign investment and infused the country with cash to finance its fiscal deficits. However, the linchpin of the new system was the introduction of the Convertibility System. At the time, there was much debate in Argentina and abroad about how to control inflation and build confidence in local currencies in order to foster investment and growth. There were three options of exchange rate management available to any government: a floating exchange rate, a super-fixed exchange rate (including the possible use of a currency board), or a hybrid system. The hybrid system consisted of various levels of control over exchange rates, and it was discredited in the early 1990s when empirical evidence from several currency crises showed that, in a world of high capital mobility, a semi-fixed exchange rate was very unstable, because it allowed a country with poor monetary policy to exercise too much discretionary power. The consequence was that a government had to choose between either fixed or fully floating exchange rate systems. Argentina's currency board established a fixed pegging of one-to-one parity between the peso and the U. S. dollar. It also guaranteed full convertibility of pesos into U. S. dollars. The government hoped to establish local and international credibility in the peg and to limit the amount of local control over monetary and fiscal policy. The currency board regime intended to stabilize the peso, encourage both foreign and local investment, and foster sustained economic growth.

FISCAL POLICY

In the early 1970s, Argentina's debt to GDP ratio was below 10%. But after 30 years, the country declared the largest debt default in history. Argentina's

debt problem started during the 1976-1982 military dictatorship. Due to the abundance of liquidity following the oil shocks, the government followed a policy of financial liberalization combined with fixed exchange rate system, which resulted in real exchange rate appreciation, and rise in both public and private sector external debt. Public sector debt was at a level of almost 40% of GDP. In 1982, following the Mexican default, Argentina became another victim of the international debt crisis, and also defaulted. The explanation given below divides the evolution of debt in Argentina since the return of democracy into four periods: 1983-1989 and 1995-2001 are generally unfavorable periods, in which external conditions were challenging for the country; growth performance was very poor and fiscal policy, debt and social conditions worsened. On the other hand, 1990-1994 and 2002-2005 were favorable periods with excellent external conditions, growth and improvements in fiscal policy, debt and social conditions. During the period 1983-1989, fiscal outcomes were negative, that is deficit of 3.7% of GDP. The debt grew from around \$40bn to almost \$65bn, mainly due to the accumulation of arrears and unpaid interest. Furthermore, the government accumulated unregistered debts (of \$25.7bn) with pensioners and other domestic creditors. The 1989 hyperinflation and devaluation caused a rise in the debt to GDP ratio of almost 120%. Between 1990 and 1994, fiscal accounts improved significantly. A primary surplus was achieved in 1992 for the first time after 30 years. The nominal stock of debt increased from \$62bn to \$81bn. However, due to robust growth, the debt to GDP ratio fell from 44% in 1990 to 32% in 1994. In the year 1993, fiscal statistics improved significantly in Argentina, due to implementation of the Financial Administration Law (Ley de Administración Financiera). This law explained

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the debt decomposition in a more detailed way and the influence of different factors on the evolution of public debt. It distinguished between the impacts of three types of effects on the debt to GDP ratio: a) Automatic debt dynamics, due to changes in the real exchange rate, the real interest rate and real GDP growth, b) The contribution of the primary deficit or surplus, and c) Other identified sources of change in debt, such as privatization receipts, debt renegotiations, debt consolidations due to off-budget government expenditures or resolution of financial crises. Public sector debt

Year	1993-05	1993-94	1995-01	2002	2003-05
Change in public sector debt	40,51, 421, 997, 7-80, 5	Primary Deficit (- surplus)	-13, 3-1, 3-1, 60, 7-9, 8	Off-budget govt. expenditure (net of privatization)	-1, 15, 11, 814, 0-22, 0
Contribution from real GDP growth	-32, 6-3, 3-1, 16, 6-34, 7	Contribution from real interest rate	28, 10, 523, 21, 14, 3	Contribution from real exchange rate change	58, 40, 25, 871, 7-18, 8

ARGENTINA GOVERNMENT BUDGET

Government Budget in Argentina is reported by the Ministry of the Economy. Its an itemized accounting of the payments received by government from taxes and other fees, and the payments made by government like purchases and transfer payments. A budget deficit occurs when government spending is more than its revenues. The opposite of budget deficit is budget surplus. Government of Argentina recorded a budget surplus of 0. 20% of the country's Gross Domestic Product in 2011. From year 2000 until 2011, Argentina Government Budget averaged 0. 1% of GDP reached high of 3. 7% of GDP in 2004 and a record low of -6. 4% of GDP in 2001. Argentina Government Budget

TRADE POILCY

Argentina adopted the common external tariff (CET) of MERCOSUR (the Southern Common Market customs union with Brazil, Uruguay, and Paraguay), and its trade regime became more open in early 1990s but the trade policy reform has been vulnerable to macroeconomic shocks. Tariffs rose during 1998-2001 as the country attempted to deal with external shocks and recession, but dropped again after the currency board was abandoned and the peso devalued. However, since the 2001-02 default crises, there has been an increasing reliance on export taxes on agricultural products as a source of fiscal revenue. Export taxes as a share of government revenue rose from 0.1% to 10% in 2002. The government suspended exports of wheat and flour in order to cope up with the food crises and to keep domestic prices low and prevent shortages for its domestic consumers. Also, in March 2008, the government raised export taxes on grains and seeds through a presidential decree (for soybeans, one of Argentina's top crop exports, export taxes rose to more than 40 % from a fixed rate of 35%). However the bill was rejected after a large protest by Argentina farmers. The government has also taken some liberalizing measures such as reducing export tariffs by 5 percentage points for wheat and corn, and eliminating taxes on 35 dairy products. However, in the context of the global recession, the financing requirements of Argentina's fiscal stimulus plans add pressure to keep export taxes high. At the beginning of 2009, Argentina introduced non-automatic import licensing requirements on steel, metallurgical, tires, and textile products, among others, which created a large bureaucratic burden on importers, and succeeded in curtailing imports. It also introduced reference prices on 1,000

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imported products such as auto parts, textiles and shoes, and imposed price references for the exports of copper. These measures have become a source of some friction between the MERCOSUR partners. In this context, Argentina has also heightened its use of anti-dumping initiations, also heightened its use of anti-dumping initiations, which went from 7 in 2007, to 20 in 2008 and has reached 16 in the first half of 2009. Argentina has continued to maintain a managed float of the peso since 2002. Over the course of 2008, the real effective exchange rate of the Argentinean peso appreciated by 1.9 percent, making exporters relatively less competitive abroad. MERCOSUR members signed an FTA with Israel in December 2007 and a preferential trade agreement (PTA) with the South African Customs Union (SACU) in December 2008. A PTA with India came into effect in June 2009. In March 2009, Paraguay increased tariffs against its MERCOSUR partners to 10–15 percent on a range of goods related to household cleaning products and paints, possibly straining relations among MERCOSUR members. Argentina's rank is 118th in the Ease of Doing Business index in 2009, which looks at the business environment in 183 countries. However, Argentina ranked 45th (out of 151) on the 2007 Logistics Performance Index, outperforming its comparators on nearly all aspects of the index. Here, its weakest indicator was efficiency of customs and other border procedures, while its strongest logistics category was timeliness of shipments? In order to address trade finance constraints, the central bank introduced a new facility that allows it to offer repurchase-agreement contracts in dollars to encourage banks to use their idle foreign-currency deposits for export financing. In order to encourage trade between Argentina and Brazil, the two countries decided in May 2009 to start trading in their own local currencies.

Trade Outcomes

After accelerating sharply in the years following the 2001–02 crisis and up until the third quarter of 2008, Argentina's real (in constant 2000 U. S. dollars) growth in total trade of goods and services decreased from 14. 2 percent in 2007 to an estimated 7. 3 percent in 2008, and is expected to shrink by 7. 9 percent in 2009. Increasing demand for agricultural products from emerging economies in Asia, along with higher commodity prices, led to the increase in Argentina exports. However, due to the economic slowdown and decreasing commodity prices, Argentina exports shrank, with total export growth slowing down from 9 percent in 2007 to an estimated 1. 7 in 2008, and projected to fall by 6. 8 in 2009. Imports of goods and services decreased from 20. 1 percent in 2007 to an estimated 13. 3 in 2008 and are expected to shrink by 9 in 2009. However, total trade growth in nominal U. S. dollars remained the same in 2007 and 2008 at approximately 25 percent, due to high commodity prices. Nominal export growth was 26. 5 percent, while nominal import growth was 29. 5 percent. However, nominal goods exports registered a decline that can be traced to the fourth quarter of 2008, which registered a sharp fall of 22 percent compared to the same quarter in 2007. National statistics register a 26 percent drop in goods exports during the first quarter of 2009 compared to the same period last year, and a 35 percent drop in imports, leading to a trade surplus. The country experienced a severe drought, which resulted in decreased agriculture production and exports. Argentina's trade share in GDP is around 45 percent, lower than an average LAC and upper-middle-income comparators' levels. The country's main export products in 2008 included animal feed, vegetable oil, oil seeds, and maize. Brazil is Argentina's main export destination market (22 percent), <https://assignbuster.com/the-argentina-economic-crisis-economics-essay/>

followed by China, the biggest purchaser of raw soybeans (11 percent), the United States (8 percent), Chile (6 percent), and Spain (4 percent). Brazil is also the largest source of Argentina's imports (33 percent), followed by the United States (15 percent) and China (12 percent each). Remittances accounted for 0. 2 percent of GDP in 2008. FDI inflows accounted for 2. 4 percent of GDP in 2008. Exhibit

argentina - Balance of payments

Previous

Last

Changes in net reserves (BoP; US dollar) in Argentina-13074596223. 5-23729339. 3Communications; computer; etc. (% of service exports; BoP) in Argentina42. 247. 1Communications; computer; etc. (% of service imports; BoP) in Argentina

Current account balance (BoP; US dollar) in Argentina7354350000. 06755860000. 0Current account balance (% of GDP) in Argentina2. 82. 1Current transfers; receipts (BoP; US dollar) in Argentina1627530000. 01867280000. 0Exports of goods and services (BoP; US dollar) in Argentina66343400000. 082174560000. 0Exports of goods; services and income (BoP; US dollar) in Argentina72967990000. 087794970000. 0Exports of goods; services; income and workers' remittances (BoP; US dollar) in Argentina73487587553. 288324375294. 6Foreign direct investment; net (BoP; US dollar) in Argentina4968920000. 08334630000. 0Foreign direct investment; net inflows (BoP; US dollar) in Argentina6473150000. 09725560000. 0Foreign direct investment;

net inflows in reporting economy (DRS; US dollar) in Argentina6473170000.
09725553970. 0Foreign direct investment; net inflows (% of
GDP) in Argentina2. 53. 0Foreign direct investment; net outflows (% of
GDP) in Argentina0. 60. 4Goods exports (BoP; US
dollar) in Argentina55980300000. 070018800000. 0Goods imports (BoP; US
dollar) in Argentina42524500000. 054596200000. 0Grants; excluding
technical cooperation (US dollar) in Argentina0. 00. 0Imports of goods and
services (BoP; US dollar) in Argentina53400300000. 068036150000.
0Imports of goods; services and income (BoP; US
dollar) in Argentina65967070000. 081208800000. 0Income payments (BoP;
US dollar) in Argentina12566770000. 013172650000. 0Income receipts (BoP;
US dollar) in Argentina6624590000. 05620410000. 0Insurance and financial
services (% of service exports; BoP) in Argentina0. 10. 2Insurance and
financial services (% of service imports; BoP) in Argentina4. 34. 0Net capital
account (BoP; US dollar) in Argentina242200000. 0361860000. 0Net current
transfers (BoP; US dollar) in Argentina353430000. 0169690000. 0Net errors
and omissions; adjusted (BoP; US dollar) in Argentina39403631.
91076909339. 3Net income (BoP; US dollar) in Argentina-5942180000. 0-
7552240000. 0Net trade in goods and services (BoP; US
dollar) in Argentina12943100000. 014138410000. 0Net trade in goods (BoP;
US dollar) in Argentina13455800000. 015422600000. 0Portfolio equity; net
inflows (BoP; US dollar) in Argentina1784940000. 0-530620000. 0Portfolio
investment; equity (DRS; US dollar) in Argentina1784940000. 0-530620000.
0Portfolio investment; excluding LCFAR (BoP; US
dollar) in Argentina7068790000. 0-8028290000. 0Profit remittances on FDI
(US dollar) in Argentina7282970000. 07901872699. 5Royalty and license
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fees; payments (BoP; US dollar) in Argentina1042140000. 01463220000.
 0Royalty and license fees; receipts (BoP; US dollar) in Argentina106180000.
 0104770000. 0Service exports (BoP; US dollar) in Argentina10363100000.
 012155760000. 0Service imports (BoP; US dollar) in Argentina10875800000.
 013439950000. 0Technical cooperation grants (US dollar) in Argentina0. 00.
 0Total reserves in months of imports in Argentina8. 46. 9Total reserves
 (includes gold; US dollar) in Argentina46149457445. 446385380342. 4Total
 reserves minus gold (US dollar) in Argentina44682057445. 444854620342.
 4Total reserves (% of total external debt) in Argentina39. 339. 0Trade in
 services (% of GDP) in Argentina8. 17. 8Transport services (% of service
 exports; BoP) in Argentina16. 114. 6Transport services (% of service imports;
 BoP) in Argentina27. 629. 1Travel services (% of service exports;
 BoP) in Argentina41. 638. 2Travel services (% of service imports;
 BoP) in Argentina36. 133. 9Workers' remittances and compensation of
 employees; paid (US dollar) in Argentina462540008. 5630148620. 6Workers'
 remittances and compensation of employees; received (% of
 GDP) in Argentina0. 20. 2Workers' remittances and compensation of
 employees; received (US dollar) in Argentina606429992. 7697565612.
 8Workers' remittances; receipts (BoP; US dollar) in Argentina541080000.
 0605910000. 0

Foreign Direct Investment in Argentina

As per an ECLAC report, Argentina was the recipient of the third biggest amount of FDI inflow among the Latin American and the Caribbean nations in 1997. The first and second places in this regard were held by Brazil and Mexico respectively. Argentina's foreign direct investment flow recorded a

substantial increment in the 1990 to 1996 time period. The annual average for this period stood at US\$2. 8 billion. This was 4 times greater than the comparable figure for the 1980s. In 1996 the FDI net inflow into Argentina climbed to US\$4. 2 billion. Compared to 1990 this was a yearly average growth of 15. 2%. As per estimates by Argentina authorities, the value of FDI assets between 1990 and 1996 stood at around US\$23. 6 billion. Some factors contributed to the rapid increase in FDI inflows into Argentina in the 1990s. They are stated below.

- Mercosur membership
- Macroeconomic stability
- A rapid re-entry into international capital markets facilitated by proper policies on conversion of foreign debt into capital
- Special incentive scheme for foreign investment
- Incentives for the automotive sector

In 1990, Argentina's FDI inflow accounted for 22% of Latin America's foreign investment inflow. The figure subsequently hovered at around 9. 8% to 13. 9% in the following 6 to 7 years. Notwithstanding the large absolute value, Argentina's share in Latin America's FDI flow declined in the later half of the 1990s. This may be accounted to certain factors, which are stated below.

- Completion of the first round of privatization for Argentinean public companies
- A host of transnational companies were interested to operate in Mercosur market but Argentina faced stiff competition from Brazil in luring these investment companies
- The advancement of alternative options of external financing in Argentina

As per reports from UNCTAD, FDI inflows to the Latin American region and the Caribbean nations increased by 44% in 2004. The figure stood at US\$ 68 billion. This increase in FDI flow for the region was registered after a 4 year sequel of decline. These figures were released by UNCTAD in its " World Investment Report 2005: Transnational Corporations and the Internationalization of R&D". The report observed that,

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the biggest increment in FDI inflows in this region were accounted for by nations with MERCOSUR membership or associate membership. Argentina leads the pack with a 125% increase. Brazil and Chile followed suit with 79% and 73% increase respectively. 2004 was a watershed year regarding policy changes in the Latin American nations. The policy changes primarily revolved round the participation of private investment in an economy's natural resource sector. This sector normally attracts huge inflows from foreign business firms. The massive upsurge in commodity prices led some Latin American governments to go in for a modification of their prevalent tax regimes. Some concerned legislations were also changed. The idea behind these government regulations was to secure the lion's share of the rent accruing from the natural resources sector for the state. These kinds of developments were observed in countries like Argentina, Venezuela, Chile and Peru. These policy measures discouraged FDI inflow to some extent. So the governments of the concerned countries made some other policy changes with an eye to attract foreign investments. They formulated newly devised investment promotion regimes in countries like Argentina and Brazil targeted at attracting investments for industrial activities. Galloping inflation in 2007 threatened to derail Argentina's road to economic recovery. Rising prices lead to apprehensions of a decline in net profit on goods for export. FDI figures for Argentina were already on the decline from 2006. Average yearly rate of growth of FDI in Argentina was 11. 2% in first quarter of the year 2006. It was lower than the comparable 26% growth it recorded in the time period from 2002 to 2006. From January 2007 to March 2007, it declined by 56. 1% and stood at 624 million dollars. This contraction was due to the effect of a 374 million dollars worth of negative reinvested earnings.

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Analysis of the Macro- economics of Argentina

Argentina is one of the largest countries in the world. It possesses definite comparative advantages in agriculture, as the country is endowed with a vast amount of highly fertile land. It is also one of the main sectors contributing almost 9-10% of the country's GDP. Many agricultural products are also sent as exports. Other sectors contributing to the country's GDP are natural resources, industry, services, banking, etc. Foreign Trade and Foreign Investment are major areas which contribute to the country's Foreign Exchange Reserves. Argentina's economy has been through many problems and changes since its Independence in 1810. The Argentinian economy which was one of the stable economies started deteriorating since 1930 due to The Great Depression. It only halted its expansion but also led to devaluation of its currency " Peso". It also faced one of the worst economic crises from 1999 to 2002. The crisis caused the fall of the government, default on the country's foreign debt, widespread unemployment, riots, the rise of alternative currencies and the end of the peso's fixed exchange rate to the US dollar. Due to the crisis from 1999-2002 the country was declared as a default and because of this it faced stoppage of foreign investment and capital flow. The Argentina Economic Crisis was because of high government spending, corruption, tax evasion and money laundering. Also fixed exchange rate and large borrowings led to increase in public debt. This led to devaluation of peso. Argentina is also facing high inflation for decades. It has experienced hyperinflation (averaging 325% a year) from 1975-1990 and also reached 5000% in 1989. . Inflation was unofficially estimated to be running at more than 25% annually in December 2010 and the latest recorded is 22% in 2012. Consumer Price Index (CPI) was recorded to be

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25% in 2010 which is very high. The Income inequality in Argentina is moderate to low level. Its Gini coefficient of about 0.445 (2010) is reported to be the lowest among Latin American countries. By 2002, the peak of the crisis, the income of the richest segment of the population was 43 times that of the poorest. These heightened levels of inequality had improved to 26 times by 2006, and to 16 times at the end of 2010. This was due to economic recovery after 2002. This along with the inflation results in loss of man-power and also affects the economy of the country. Argentina recovered from the crisis because of devalued peso which made exports cheap and competitive abroad and discouraged imports. High price of Soy produced massive foreign currency. The government encouraged import substitution and accessible credit for businesses, staged an aggressive plan to improve tax collection, and allocated large sums for social welfare, while controlling expenditure in other fields. The peso slowly rose, reaching a 3-to-1 rate to the dollar. Agricultural exports grew and tourism returned. The central bank started rebuilding its dollar reserves. The downside of this reserve accumulation strategy is that the dollars had to be bought with freshly issued pesos, which risked inflation. The central bank sterilized its purchases by selling Treasury letters. In this way the exchange rate stabilized near 3: 1. The role of Central Bank of Argentina, (Spanish) Banco Central de la República Argentina, BCRA after the crisis in 2002 was the accumulation of reserves in order to gain a measure of control of the exchange rate. The BCRA buys dollars from the market to neutralize the large surplus of the foreign trade balance and keep the official exchange rate at internationally competitive levels for Argentina exports and import substitution. The Argentina Currency Board pegged the Argentina peso to the U. S. dollar between 1991 and 2002 in an attempt

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to eliminate hyperinflation and stimulate economic growth. Argentina's currency board established a fixed pegging of one-to-one parity between the peso and the U. S. dollar. It also guaranteed full convertibility of pesos into U. S. dollars. The government hoped to establish local and international credibility in the peg and to limit the amount of local control over monetary and fiscal policy. The currency board regime intended to stabilize the peso, encourage both foreign and local investment, and foster sustained economic growth. The central bank also did well in clearing out the debt to IMF. Exhibit

Facts about Argentina

Argentina declared independence from Spain on the 9th of July, 1816.

Current President, Cristina Fernández de Kirchner, was the first woman

President to be elected in Argentina. Argentina is the 30th largest country in

the world by population, with just over 40 million people. The official

currency of Argentina is the peso. Argentina were one of the first countries to

have radio broadcasting. The first broadcast was made on the 27th of

August, 1920. Only twenty people had a receiver at the time! Average life

expectancy in Argentina is 76 years. About 10% of people living in Argentina

have private health cover. Argentina has a very good literacy rate- 97. 6%.

This ranks them at equal 58th in the world. The official language of Argentina

is Spanish, although many people speak Italian and German. Some

indigenous populations still speak their native languages. Pato is the official

national sport of Argentina. It is a combination of polo and basketball.

Football (soccer) is the most popular sport in Argentina. A major export of

Argentina is wine. Like animated films? The world's first animated films were

made and released in Argentina, by a man named Quirino Cristiani in 1917.

The Teatro Colón, located in Buenos Aires (the capital and largest city of Argentina), is one of the great opera houses in the world. Argentina loves movies! They have one of the highest rates of movie watching in the world. They enjoy watching both locally made movies and Hollywood movies. The Argentina government has estimated that 750, 000 people living in Argentina are illegal immigrants. 20% of the population (according to the 2001 census) lack indoor running water and/or indoor plumbing. Argentina produces a lot of honey, soybeans, sunflower seeds, maize and wheat. Crocodiles live in Argentina. The hottest and coldest temperatures ever recorded in South America have occurred in Argentina. Argentina is divided into 23 provinces. There are about 70, 000 members in the Argentina armed forces