



Stanley Fischer

Remarks to the Argentine Bankers Association

by Stanley Fischer

First Deputy Managing Director

International Monetary Fund

at the Argentine Bankers Association Meeting

Buenos Aires, June 25, 2001

Introduction

See [Argentina](#) and the IMF

See [Brazil](#) and the IMF

**E-Mail
Notification**

Subscribe

or

Modify

your
subscription

- It is a great pleasure to be here today and to speak to this distinguished audience. As you may know, I will soon be stepping down as FDMD of the Fund, and I am very happy to have this opportunity to visit Argentina for the last time in my official capacity.
- It is fifteen years since I last spoke to this meeting of Argentina's leading bankers – at that time it was to a meeting of ADEBA. On that occasion, I talked about international policy coordination. And after my visit in 1986, I wrote an article entitled "Argentina at the Crossroads – Again", which was published in *Cronista Commercial*.
- The safest thing I could do today would be to deliver another lecture on international policy coordination. Or I could adopt the Alan Greenspan approach: after one of his more complicated speeches he told the audience: "If you have understood what I said, then I must have made a mistake".
- But much as I probably should do that – and despite the advertized title of this address – I will talk about the Argentinian economy
- I will start by reviewing the impressive developments in the Argentine economy over the past decade. Then I will turn to the current policy challenges, discussing in turn structural and fiscal policies.

Past Record

- These are difficult times for Argentina. Argentina is not helped by the difficult external environment:
 - o The global slowdown is hitting export demand;

- o The strength of the dollar has complicated the process of adjustment, and;
- o The average emerging market interest rate spread has risen, albeit by less than the amount by which Argentina's spread has risen.
- But, as we consider the difficulties of the current situation, we should not lose sight of Argentina's major achievements during the past decade:
 - o Democracy has been consolidated, with a smooth political transition taking place between the administrations of Presidents Menem and de la Rúa;
 - o Macroeconomic and financial stability was established. Inflation of course declined dramatically. This was the great historic achievement of the convertibility plan. Prices were increasing by more than 3000 percent per annum when inflation peaked in 1989, but were barely changed between 1995 and 2000.
 - o Impressively, this improvement in inflation did not come at the expense of growth. On the contrary: Argentina greatly improved its growth performance, moving from an average output decline of 0.5 percent a year in the 1980s to average output growth of almost 4 percent a year in the 1990s.
 - o The public sector has been slimmed down, by divesting inefficient public enterprises and reforming the federal civil service. Argentina moved very fast and far indeed in privatizing state enterprises. It would be a mistake to reverse any aspect of that;
 - o Significant progress has been made in deregulation;
 - o Trade and capital accounts have been liberalized, opening up the economy both within and outside Mercosur. Exports have doubled since 1990 to more than 9 percent of GDP – but to say that is also to emphasize that Argentina has a long way to go to insert itself fully into the global trading system;
 - o In this regard, let me very strongly support the consistent emphasis by Minister Cavallo on the need for Argentina to liberalize its trading arrangements with the rest of the world, including not only Mercosur, but also the remainder of this hemisphere, and Europe. That is a critical part of the growth strategy for Argentina;

- o The financial sector has been greatly strengthened, thanks both to much improved regulation and supervision, and to increased foreign involvement. But more needs to be done to:
 - make the banking system more efficient;
 - reduce intermediation spreads, and;
 - facilitate recovery of collateral for non-performing loans.
- Low burdens of foreign and domestic debt at the beginning of the period helped.
- **But** the growth performance was based too much on large fiscal deficits, especially as the decade progressed. The deficit of the federal government averaged 1 percent of GDP in the first half of the 1990s and 3 percent in the second half.
- The problem was partly a result of terms-of-trade shocks and a deteriorating external environment in the late-90s. But it was also a result of a lack of fiscal adjustment and inadequate progress in structural reforms, especially of the labor market.

The Current Challenge

- This background of impressive achievement by Argentina sets the scene for the current challenges confronting economic policy in Argentina. The current situation is a result of the dependence of growth on too large fiscal deficits, of inadequate progress in structural reforms, especially of the labor market, and of external shocks. There are three mutually reinforcing concerns:
 - o Weak economic activity;
 - o A weak fiscal position, and;
 - o Weak investor and consumer confidence.
- Getting out of this situation is not easy – but Argentina has got out of difficult situations in the past, including during the tequila crisis in 1995, when the government, with Domingo Cavallo as Finance Minister moved decisively to stabilize the economy in April, including by tightening fiscal policy just a few months before an election.
- The Argentine authorities have taken a two track approach to dealing with the present crisis:
 - o Enacting structural reforms to promote growth, and;

- o Strengthening the fiscal position of both the federal and provincial governments.
- The IMF supports this approach, and demonstrated this support in very concrete terms in December last year by increasing the size of its financial arrangement with Argentina, to provide a total package worth approximately \$13.5bn – over 500 percent of Argentina's quota in the Fund.
- Let me deal with structural and fiscal policies in turn.

Structural Policies

- The government put in place a number of structural policies in April, designed to improve growth:
 - o Changing the structure of extra-Mercosur tariffs;
 - o Lowering VAT on domestically-produced capital goods, and;
 - o "Competitiveness plans" – incentives and regulatory changes to boost growth in particular sectors.
- Last week the government announced fresh measures, including the "empalme", an import tariff and export subsidy to mimic the eventual move to a euro/dollar basket for the exchange rate.
- These incentives implies by these measures should contribute to boosting growth, but they also take policy in a more interventionist direction that if pushed much further could reduce efficiency and confidence in the longer term.
- It is important to press ahead with the market-friendly pro-growth reforms outlined in Argentina's economic program supported by the IMF, especially:
 - o Promoting competition in domestic markets (eg ports and telecoms);
 - o Implementing the labor market reform approved by congress a year ago;
 - o Implementing the proposed deregulation of the obras sociales (the union-run health system).
- The authorities have also announced structural reforms in the fiscal area, including plans to:

- o streamline the tax system;
- o strengthen tax enforcement, and;
- o introduce needed reforms in the social security system.
- These announcements are welcome. The implementation of these measures is difficult, but is needed if confidence is to be bolstered in a lasting way.
- Let me turn now to the aggregate aspects of fiscal policy

Fiscal Policy

- The question that has to be asked at this time of recession is whether Argentina really needs fiscal adjustment. The obvious concern is that such an adjustment would only impede the recovery of the economy.
- After all, neither public debt (at around 50% of GDP) nor the fiscal deficit (at around 2.5% of GDP) are particularly high by international standards – indeed both would satisfy the Maastricht criteria, as would its inflation performance.
- The problem is that with the current level of spreads on Argentine bonds, the debt dynamics are on an escalating path.
- In addition, Argentina's gross financing requirements are large – although to be sure the recent successful debt exchange significantly and importantly reduced the gross financing needs for the next few years.
- High interest rates, in turn, stifle prospects for sustained recovery, worsening the debt dynamics. So, it seems obvious that the fiscal deficit should be cut.
- Nonetheless we have to ask the question: won't a fiscal contraction only contribute to a *vicious circle* of low growth, leading to a worse budget situation, leading to more fiscal contraction, leading to yet lower growth, etc.
- But experience in several countries (including Ireland, Denmark, Italy and Brazil) suggests that fiscal tightening can be expansionary – can lead to a *virtuous circle*. How? The answer is simple – by producing a sustained reduction in the risk premium and domestic interest rates. And no-one doubts the need for lower interest rates.

- There is now widespread acceptance of these realities in Argentina, as is evident from the passage and general understanding of the Fiscal Responsibility Law.
- The current crisis was triggered by bad fiscal news in Q1, which threatened to see the deficit come in at more than \$10bn instead of the \$6.5bn laid down in the program and the Fiscal Responsibility Law.
- So the authorities announced measures in April worth \$3.8bn, including \$2.5bn from the financial transactions tax and \$900m in spending cuts.
- The authorities are also expecting a modest further net boost to revenue from the measures announced last week.
- But there is significant uncertainty about the yield of some of these measures, especially in view of their administrative complexity.
- We are concerned about the strains this complexity will place on an already weak revenue administration.
- More needs to be done on the expenditure side. The evidence is very clear that expenditure cuts are more effective than tax increases in sustaining fiscal consolidation and boosting growth. For example, there is a need to ensure that the wage bill is under control.
- To this end, keeping spending by the provinces under control is essential. The federal government has been more successful than the provinces in improving its fiscal position.
- Argentina is certainly capable of a stronger fiscal performance. It was done by your neighbor, Brazil; it has been done elsewhere in this hemisphere; and it is being done in Turkey.

Monetary Policy

- I have not so far talked about monetary policy. That is hardly a surprise given the convertibility regime, which fundamentally determines what monetary policy shall be. While there is some flexibility within the system to vary liquidity countercyclically, that flexibility is very limited indeed.
- Argentina has been very well served by the measures the Central Bank has taken during the past decade to strengthen the banking system. The strength of the banking system has enabled Argentina

to withstand major external shocks, and maintenance of the strength of the banking system remains essential to the future of this economy.

- To maintain the strength of the system, it is essential to maintain the independence of the central bank.

Conclusion

- Argentina today faces a major challenge to sustain and strengthen the achievements of the last decade.
- But Argentina has met challenges in the past and can do so again.
- The path to success is to continue fiscal and structural reforms. Policy needs to be set in a way that inspires confidence, in particular by avoiding inconsistent signals
- That way lies the virtuous circle of restored growth, greater confidence, and an improving fiscal outlook.
- It can be done – and for the sake of all Argentinians, it should be done.
- Thank you.

Table: Public Sector Operations
(In percent of GDP)

	1998	1999	2000	2001
(Primary balance)				
Argentina	0.5	-0.8	0.5	1.6
Brazil	0.0	3.2	3.5	3.0
Ecuador	-1.2	4.0	9.3	6.2
Jamaica	1.3	7.1	11.0	12.6
(Overall Balance)				
Argentina	-2.1	-4.2	-3.6	-3.2
Brazil	-7.9	-10.0	-4.6	-3.5
Ecuador	-5.9	-7.0	1.5	-0.3
Jamaica	-9.4	-11.1	-7.4	-5.3

Source: IMF Staff Reports

IMF EXTERNAL RELATIONS DEPARTMENT
Public Affairs: 202-623-7300 - Fax: 202-623-6278
Media Relations: 202-623-7100 - Fax: 202-623-6772

[IMF Home](#) [Search](#) [Site Map](#) [Site Index](#) [Help](#) [What's New](#)
[About the IMF](#) [News](#) [Publications](#) [Country Info](#) [IMF Finances](#) [Standards & Codes](#)

