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Reforms needed urgently

Roberto Lavagna

Former Minister of Economy of Argentina

Solange Monteiro

AFTER ARGENTINA DEFAULTED IN 2001, Roberto Lavagna, its economy minister (2002–05), successfully negotiated the restructuring of Argentine debt as of January 14, 2005. The recent judgment of the Supreme Court of the United States in favor of creditors who opted out of the debt restructuring in 2005 has put Argentina back in the international spotlight. Today, he says, Argentina is held back by two issues: reforms of the international finance system to prevent interpretations of debt contracts that create uncertainties in the sovereign debt market; and changes to its economic policy to fight inflation and resume growth. Lavagna is critical of the current government's management of the economy and now supports the Renewal Front party, whose candidate for president, Congressman Sergio Massa, is ahead in the opinion polls. Lavagna argues that Brazil as well as Argentina needs to address its domestic problems to promote competitiveness and growth. "We are limiting ourselves when interest rates rise in Brazil, or policy controls are imposed in Argentina," he says.

***The Brazilian Economy*—The US Supreme Court ruling on Argentina's payment of creditors has produced international support for but also criticism of Argentina. What is your opinion?**

Roberto Lavagna—We need to put the ruling in the context of the enormous influence that certain financial sectors have on the rules that move world finances. As a consequence of deregulation in the 1980s and 1990s, we ended up in a huge global crisis in 2008. After deregulation, we thought new rules were necessary, but the financial sector managed to delay some, weaken some, and

to some extent nullify them. In the current case the influence of the financial sector was able to use courts to change the criterion of equal treatment for all creditors. The new interpretation now is that some creditors can be treated differently. Thus, it gives the 2% of lenders who are litigating against Argentina a position of privilege at the expense of the more than 90% that renegotiated their claims. The governments of countries like the USA, France, Brazil, and the Group of 77—and even *The Financial Times*, a spokesman for international finance—consider this decision excessive.

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This is not to ignore the fact that for years the Argentine government has neglected its debt problems. Indeed, changes in economic policy since 2007 have put these issues aside, which was a mistake. But such domestic error has to be put in the more worrying context of international finance today. The International Monetary Fund has also expressed concern about how to interpret the changes, and it is clear that the international financial system needs additional reforms. The negative impact of this decision is obvious, Christine Lagarde, managing director of the International Monetary Fund, has made it very clear that sovereign debt restructurings will become more complex if this interpretation holds.

Do you think Argentina was correct to focus on deficit reduction without seeking the help of the international financial system?

Here my opinion is straightforward: The debt renegotiation proposal negotiated in 2005 said clearly that the estimated 75% reduction in the debt assumed that Argentina would not seek funding in international markets until December 31, 2014—10 years from the agreement. Of course, this policy decision did not please bankers, who could have lent to Argentina and even today are offering credit. The decision was made so that Argentina would not enter into another borrowing binge. Our position was to go to the markets only to manage our debt: If US$1 billion in debt matured, we would issue US$1 billion in debt; and if we had debt with a 5-year maturity and we could change it to a 10-year maturity, we would do it. The goal was to achieve a debt-to-GDP ratio of 30%.

Debt management had caused much trouble for Argentina in the past, and opting for an easy borrowing policy was out of the question. On the other hand, at that time Argentina had fiscal surplus of 4.5 points—a mass of available resources.

How may the economic imbalances have affected how creditors assessed the health of the Argentine economy?

I'm critical of macroeconomic policy since 2007. There have been serious macroeconomic errors, and they primarily relate to domestic issues—not to international creditors but to our own situation. Since the crisis of 2001 there have been three very different periods: From mid-2002 to 2006, the country grew 9% per year, with a primary fiscal surplus of 4.5% of

GDP, an external current account balance of 3.5% of GDP, and annual inflation of 9% to 11%. Then there were economic policy changes in 2007. In the second period, from 2007 to 2011, growth was cut in half, to 4.5%, and in the third, from 2012 to 2014, growth sank to about 1%, annual inflation shot up to between 35% and 38%, the fiscal deficit rose to 3% of GDP, and the precarious external current account balance was dealt with only by the imposition of exchange controls in 2011.

The results are obvious to anyone. It is clear that there have been changes, they have been negative, and they may have affected not only creditors but also the Argentine population. I say "may" because since 2005 the country has fulfilled its debt obligations. I believe that, like Brazil, we will be making a big mistake if we blame the international context [for our problems]. Close to us, countries like Uruguay, Peru, Chile, and Colombia live in the same world but are in better condition. We need to acknowledge that there are local problems in how economic policy is being managed. It would be too easy to blame the world outside.

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What advice would you give to the next economy minister?

Here it is best to talk about the facts. From mid-2002 to early 2006, economic and social policy produced real results. Of course everything has to be adapted to the context of the moment, but I think there are guidelines for how to manage macroeconomic policy. When I left the ministry two important measures had been submitted to Congress but were abandoned. One was a major tax cut. The other was creation of a countercyclical fund. At that time Argentina was running a fiscal surplus of 4.5% of GDP, so it would have been possible to build a reserve fund for when the times became less favorable. Chile established a countercyclical fund in 2007, and in a few years the fund totaled over US$20 billion. In Argentina, the tax cut did not occur, and taxes have surged since 2007, affecting the private sector, especially small and medium businesses, which are less able to cope with it. Economic growth has declined. In the current situation in Argentina, it would be interesting to think about a tax cut in order to spur investment and create jobs, and about creating a countercyclical fund.

How do you think the country will be affected by the presidential election in 2015?

How will the transition work? It's hard to say. My feeling is that inflation will continue to be high—we will not be able to reduce inflation by more than 1.8–2% monthly—investment will be low, and very few jobs will be created. This situation is complicated because Argentina's main trading partner is Brazil, where growth has been low for several years. It seems that what awaits us is no large open crisis, but continuing low growth. We have improved official price indices to some

extent, but there are still important differences between private and government estimates. This means that as yet there is no credibility to encourage private sector activity.

What alternatives does the country have to attract foreign exchange, besides exports and reducing controls on imports?

Currently Argentina's number one task is to avoid capital flight. Due to distrust of economic policies, manipulation of price indexes, and low economic growth, there is flight, and not just of foreign capital. Of course it is good to attract foreign investment, but the country cannot do so without giving assurances to its own people.

What should Argentina do to become more active in global value chains?

This is a challenge not just for Argentina but for all South American countries. In our case, however, it is more difficult because we have no private investment and job creation. What Brazil and Argentina have in common today is that their industry is not competitive internationally. No need to explain the situation in Brazil, where exports are dominated by primary commodities. Here we have a point in common—we reached it in different ways, but the situation is the same.

Do you agree that the Mercosur customs union is bankrupt and that it is necessary to reestablish the bloc as a free trade area?

I do not think that is the way to go. Mercosur has to address many things; it has to negotiate trade agreements with countries of both the Pacific Alliance and the European Union. To do this, however, Brazil and Argentina have to address their own lack of competitiveness—it is not sufficient to support negotiation in other areas. Both countries have to make domestic adjustments.

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How could Brazil and Argentina help each other to do this?

Argentina's growth potential is huge. So is Brazil's. I have no doubt that both countries will continue to have the great advantage of international demand and prices for their products, especially soy, which will last for some time. Both have important potential: deep sea oil for Brazil, and Vaca Muerta, one of the world's largest reserves of unconventional hydrocarbons, for Argentina. This is a formidable base. It is a great starting point to build an industrial, technological, globally competitive industry. We just have to find our way. We are limiting ourselves by rising interest rates in Brazil or imposing policy controls as Argentina has done.