

Argentina: A Rescue Plan That Works

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Argentina is waiting for the next bailout, a shipment from the IMF that helps resolving the myriad unresolved issues in economics, politics and the social area. Of course, everybody knows that this is not the answer. The truth is that Argentina is bankrupt. Bankrupt economically, politically and socially. Its institutions are dysfunctional, its government disreputable, its social cohesion collapsed. Having fallen that deep, it comes as no surprise that reconstruction rather than quick-fix financial support has to be the answer. Argentina is like the European economies in the early 1920s, not a country with a liquidity issue that needs a tough year and is back on its feet like say Korea, Mexico or Brazil.

It is time to get radical. Any plausible reconstruction program must be built around three points:

- The recognition that this will be an effort of a decade, not of a few years. Argentina's productive economy, its credit and its institutions have been destroyed. Both its physical and moral capital will have to be built up and that takes a very long time.
- Because Argentine polity has become overburdened, it must temporarily surrender its sovereignty on all financial issues. Financial soundness is the key area where a beach head of stability must be created to even start thinking about sound public finance, saving and investment.
- The rest of the world should provide financial support to Argentina. But it must do it only upon Argentina's acceptance of radical reform and foreign hands-on control and supervision of fiscal spending, money printing and tax administration. Any external loan is to bridge the gap between immediate fiscal needs and the day, a year or two down the road, where radical reform creates sustainable finance.

Argentina today is bankrupt and slipping further. On the current course of events, money printing will cover up unresolved claims only so long. Far from resolving the open issues, financial and public chaos will further destroy the bases for a reconstruction. A wasteful distributional battle is taking place between workers and the wealthy, those who are trapped by the bank closure and those who have their money in Miami, between provinces and Buenos Aires, between unions and businesses, between foreign investors or creditors and a nation that wants to shed obligations in a vain effort to maintain some normalcy. Argentina is being cannibalized by this strife. Further IMF money without a deeply intrusive change of the rules of the game won't prevent self-destruction.

Argentines must humbly acknowledge that without massive external support and intrusion they can't get out of the mess. What kind of external support? It goes well beyond funding. At the heart of Argentina's problems is a crisis of trust as a society and confidence in the future of the economy. No one group is willing to concede the power to resolve the claims and fix the country to any other local group. Somebody has to run the country with a tight grip; dictatorship is neither likely nor desirable. But since everybody thinks ---often correctly --- that everybody else is selfish and corrupt, there is no social pact that can be reached. No local group will let another local group run the show. Without this social pact, day-to-day cannibalization of social and economic capital will continue. Ever more gruesome outcomes are on the horizon.

Argentina now must give up much of its monetary, fiscal, regulatory and asset management sovereignty for an extended period, say five years. This is not unheard of. In the aftermath of World War I, Austria dramatized its needs to the League of Nations who recognized the fundamental problem of a dysfunctional society. It resolved that question, along with financial support, by having—with the consent of parliament-- a resident Commissioner General, appointed by and responsible to The League of Nations. The CG had to sign off on every spending bill, supervise the central bank and monitor reform. Here is the tough language of the League report. *“But the successful accomplishment of the reform program, on which Austria's prosperity and the value of her assets depend, would necessarily be a difficult and painful task. The scheme therefore included the appointment of a Commissioner General, whose duty was to ensure, in collaboration with the Austrian government, that the program of reforms was carried out and to supervise its execution. He would derive power from his control of the disposal of the loan.”*

It worked! And here is what Argentina must accept to do. A board of experienced foreign central bankers should take control of Argentina's monetary policy. This solution would have many of the reputation-virtues of a currency board, without the costs of having to adopt a monetary policy tailored to somebody else's needs. The new pesos should not be printed in Argentina's soil.

Another foreign agent is needed to verify fiscal performance and sign the checks from the nation to the provinces. Much of the fiscal problem has to do with fiscal federalism in designing and enforcing a sharing of responsibilities and resources in a way that is financially affordable.

Tax evasion and corruption—and the government's acceptance of this state of affairs-- has to be suppressed in the most radical fashion. Foreign micromanagement is not feasible but agreed incentive mechanisms and a sharing of experience are. Argentina is not the first country to experience tax collection issues, effective answers are available and must be imposed. Involvement of the provinces in the effort – with a lower basic co-participation share to 30% or so, but steep incentives for local tax collection and revenue improvements are part of the answer. Proportional is not enough – perhaps go as high as giving the provinces more than a peso for each extra peso of revenue above certain

threshold. Also, because tax enforcement benefits from a simple tax structure, there is no space for a cumbersome tax code. It must be simplified to the bare basics --- flat flat flat.

Argentina's economy has been run down; it now needs an immediate productivity boost, pending a resumption of long neglected investment, and an eradication of corruption as a way of life. The incentive mechanism in the new tax-code should help controlling corruption at the province-level. Workers must become equity holders, enter into profit sharing agreements. Aside from the flexibility advantages of such system, it adds an extra layer of profit monitoring and of tax-evasion control to the system.

A massive privatization campaign of ports, customs, and other key obstacles to productivity must now take place. Deregulation of the wholesale and distribution sectors is essential. Another experienced foreign agent should control these processes, as well as make sure that the proceeds end up somewhere safe for all present and future Argentines to share.

With the commitment to a clear and radical plan, Argentina would suddenly offer a fresh and encouraging new look. An awfully dark short run scenario would suddenly have a reasonable chance of a successful ending. While the foreign monetary board is setup, move quickly ---yesterday--- to a new *temporary* convertibility plan, say two pesos on the dollar just because it is the next simple number after one-on-one. Release the "corralito" and let the IMF and other IFIs decide which banks to support and how... it is their money after all. Foreign capital is quick to change its mind; there can be hope again. But to get there, there is no escape from radical, intrusive reform.

It is well worth recording what the League said on the eve of the Austria program: *"At the best, the conditions of life in Austria must be worse next year, when she is painfully reestablishing her position, than last year when she was devoting loans intended for that purpose to current consumption. The alternative is not between continuing the conditions of life of last year or improving them. It is between enduring a period of perhaps greater hardship .. (but with the prospect of real improvement thereafter—the happier alternative) or collapsing into a chaos of destitution and starvation to which there is no modern analogy outside Russia. There is no hope for Austria unless she is prepared to endure and support an authority which must enforce reforms entailing harder conditions than those at present prevailing..."* Let there be no doubt, this is the situation of Argentina today; let there be no doubt, IMF money as usual would be a dramatic error.