

COVID-19 and the Economic Crisis in Argentina

Written by Priscila Palacio

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PRISCILA PALACIO, JUL 21 2020

The pandemic caused by the spread of COVID-19, around the world, impacted many countries during the first half of 2020. The main impacts were not only of a sanitary, social, and psychological type but also economic. The current crisis has started in China, where the virus originated, and spread across the Asian region, the United States, Europe, and other developed and developing economies. The economic crisis that followed was due to the need to restrict the physical contact between people to reduce the spread of the virus.

In many economies, a large part of manufacturing systems, commercialization, and distribution of goods and services were suspended and/or readapted, affecting at least, in the medium term, the living arrangements of contemporary societies. Although it is premature to evaluate the effects of this pandemic in the long term, we could observe that some countries are returning to everyday life, trying to recover (even with protocols) economic activity and social development. In some economies, there are even signs of recovery after having overcome the most complex stage of the health crisis.

In the case of Argentina, the territorial distance of the original centers of diffusion of the COVID-19 helped to defer its arrival, concerning the developments experienced in other countries. According to the Argentine Ministry of Health, they detected the first case of coronavirus in the country on March 3rd, 2020. Even though the number of infections increased significantly in the following months, possibly, due to the so-called community circulation, the increase in health checks, and also the beginning of the winter season.

Even so, the Alberto Fernández administration – which began its mandate in December 2019, decided to decree a “total and mandatory quarantine” from March 20th, 2020, with Argentina being the first country to take this provision at the regional level. The measure, established by a Decree of the National Executive, was called “ASPO” (preventive and compulsory social isolation). Initially, it would last up to March 31st, 2020, although it could be renewed in response to the epidemiological situation (Article 1, Decree 297/20). The decree established that “during the period of “social, preventive and compulsory isolation”, people must [...] abstain from attending their workplaces and may not move along routes, roads, and public spaces, all to prevent the circulation and transmission of the COVID-19 virus [...]” (Article 2, Decree 297/20 -own translation). The restriction of the movement fell on a large part of Argentine society, except for the operation of some sectors so-called essentials (linked to health, food, public transport, information services, among others).

The truth is that, with a greater or lesser degree of controls and restrictions, the isolation imposed by the government has extended for more than one hundred days – especially for the region of Buenos Aires and the City of Buenos Aires (so-called AMBA), where the largest number of people with COVID-19 are concentrated within the country. However, to understand the impact that the global pandemic and, especially, the consequent restrictions imposed by the Fernández government have had on Argentina’s domestic economy, it is necessary to review the situation it did exhibit before establishing compulsory isolation.

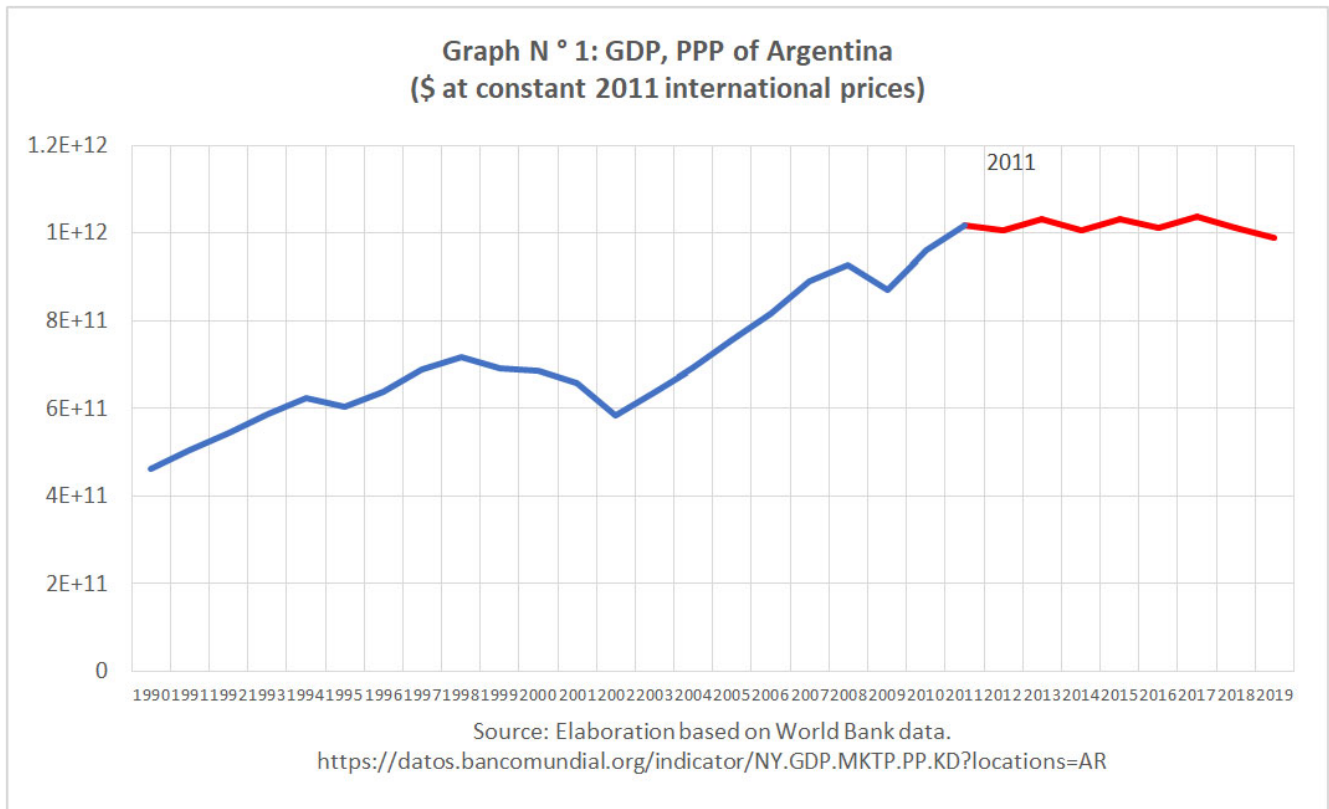
A Long Impasse in the Performance of the Argentine Economy

Since 2011 Argentina has been experiencing, a prolonged process of economic stagnation marked by successive stagflation crises: stagnation and recession with inflation (Figures 1 and 2). On the one hand, this phenomenon was a

COVID-19 and the Economic Crisis in Argentina

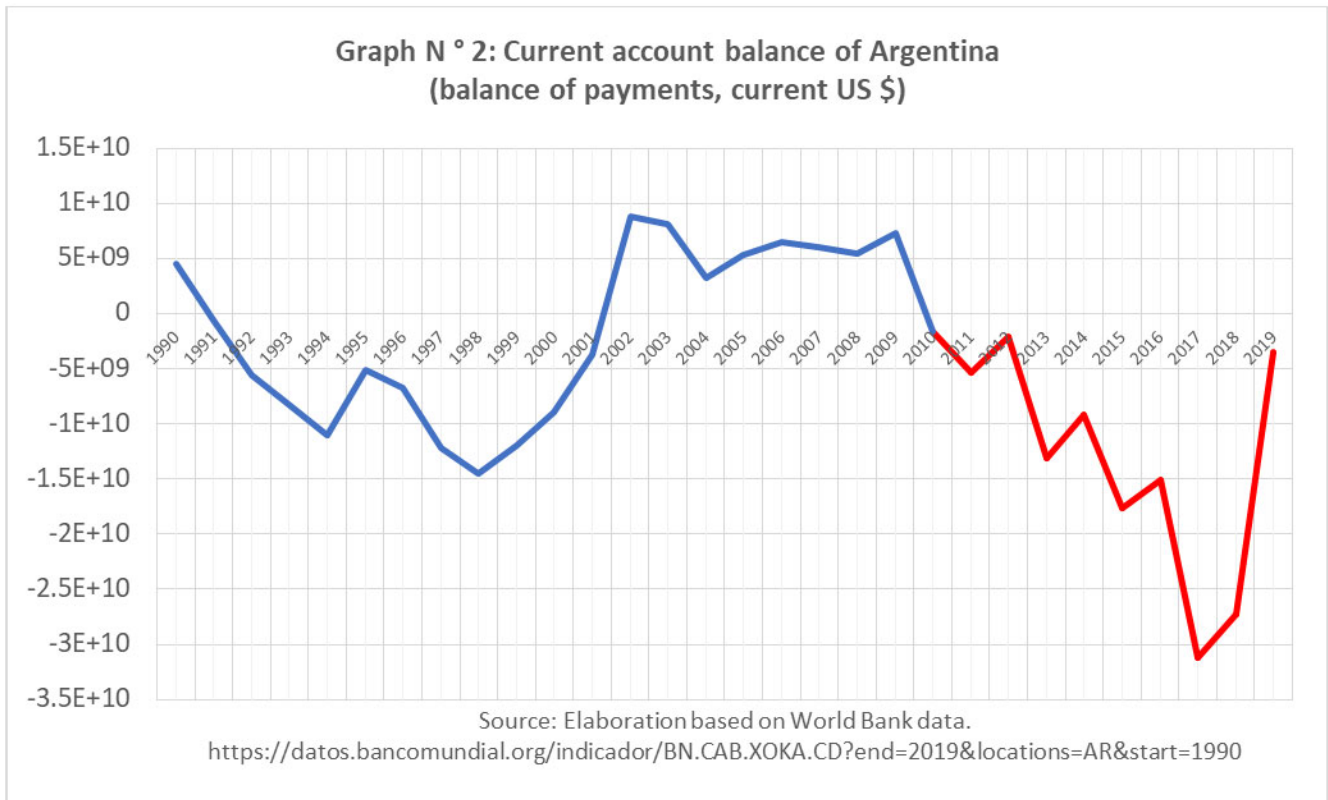
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consequence of the crisis that started in 2008 at an international level; on the other hand, by the erratic domestic policies that led to a deterioration of the Balance of Payments and the increase in inflation during the second government of Cristina Fernández de Kirchner (Palacio, 2019 (a)). Although inflation had grown since 2007, its levels increased by 2011 (not reflected in the INDEC figures, due to the government's intervention). Even so, in a stagflation context and, with several allegations of corruption that pointed to the management of Cristina Fernández, on November 22nd, 2015, the candidate of the Alianza Cambiemos -Mauricio Macri, prevailed in the elections by a narrow margin (second round).



COVID-19 and the Economic Crisis in Argentina

Written by Priscila Palacio



The beginning of the Macri administration coincided with the deepening of some changes worldwide, which marked an attempt to return to protectionism along with questionings about globalization and economic liberalism. On the contrary, while the world started to close, the Macri government did support the rhetoric of the country's reintegration into the world arena, via an opening of the Argentine economy and foreign policy.

Amongst his first policies, the government liberalized exchange controls (the former government of Cristina Fernández had tightened it). This liberalization had the hope of attracting huge investments to the country (so-called investment rain). Also, with the same purpose, the government removed and reduced the withholdings that taxed the exportations of the field, and, months later -in 2016, Argentina ended up agreeing with the holdouts to lift the international precautionary measures that prevented the payment of the external debt.

The Macri administration was concerned with reestablishing relations with the United States and distancing itself from those regional governments that held "left or populist" flags - making clear the realignment of Argentina's foreign policy in Latin America. Likewise, it marked the return of Argentina to the international economic arena. However, despite the international praise that Macri's foreign policy received, his management did not achieve the "investment rain" that he had foreshadowed. On the contrary, the imbalances that the Argentine economy had been experiencing, since 2011, worsened under his government. From the beginning, the economic team resorted to financing in the capital market, increasing the country's debt stock. Even so, the policies aimed at normalizing (readjusting) the domestic economy, led to a deepening of stagflation - above all, due to the sharp readjustment of public service rates.

Debt issuance failed to slow down the currency speculation, which had increased in the capital market without state controls. Since the beginning of 2018, a sharp fall in reserves was made explicit and, the government decided to resort to an emergency loan from the IMF, marking the return of Argentina to that international agency. However, despite the significant help that the country received from the IMF - qualified as "historic" by the government itself, the flight of reserves continued, and the speculation did not stop. For the second half of 2018, the national currency (peso) experienced a dramatic depreciation.

COVID-19 and the Economic Crisis in Argentina

Written by Priscila Palacio

Macri's economic policy fell in a pernicious cycle of debt issuance, inflation, high-interest rates, and depreciation of the national currency. Even in the second half of 2018, due to the deepening of the economic crisis, the government decided to review some of its first liberalization measures, as it reinstated export tariffs and incorporated – as a novelty for the Argentine economy, the export tax on services (Palacio, 2019 (b)).

In the social sphere, Macri's management improved some mechanisms of distribution of resources inherited from the Kirchner governments, but he continued with the policy of monetary transfers (called "social plans"). Even so, the increase in inflation and the economic recession, in 2019, led to a further increase in poverty indicators.

So, in a conjuncture of worsening economic and social situation, the October 2019 elections evidenced the failure of the Cambiemos coalition and the triumph of the formula led by Alberto Fernández/Cristina Fernández de Kirchner – Macri became the first president of Argentina to lose presidential reelection. His government ended up undoing with his elbow what he had written by hand. Despite the help of the IMF, between 2018 and 2019, Argentina not only squandered its reserves, but Macri had to reinstate exchange control in the last months of his administration. Since September 2nd, 2019, Macri's government imposed the first restrictions to contain the flight of reserves, limiting purchases above 10,000 US dollars per person, per month (Communication "A" 6770/2019, BCRA). After the electoral failure, it established a new limit for purchases of the so-called "savings dollars" (up to 200 US dollars per person, per month, Communication "A" 6815/2019, BCRA). In a way, the measure responded to the demand of the elected candidate, Fernández, to stop the fall in reserves that, according to estimates, could deepen after the electoral defeat of Cambiemos.

BCRA International Reserves (in millions of dollars, provisional figures subject to change in valuation). Source: Own elaboration based on BCRA data.

COVID-19 and the Economic Crisis in Argentina

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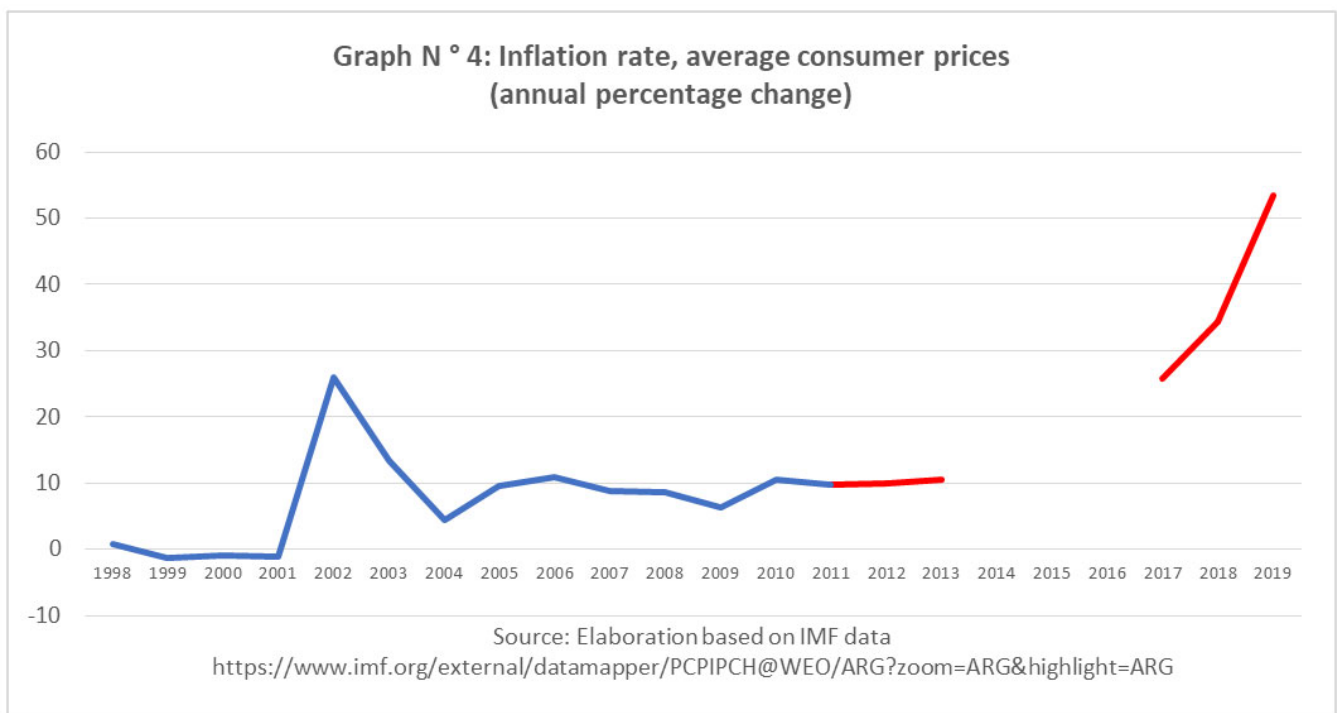
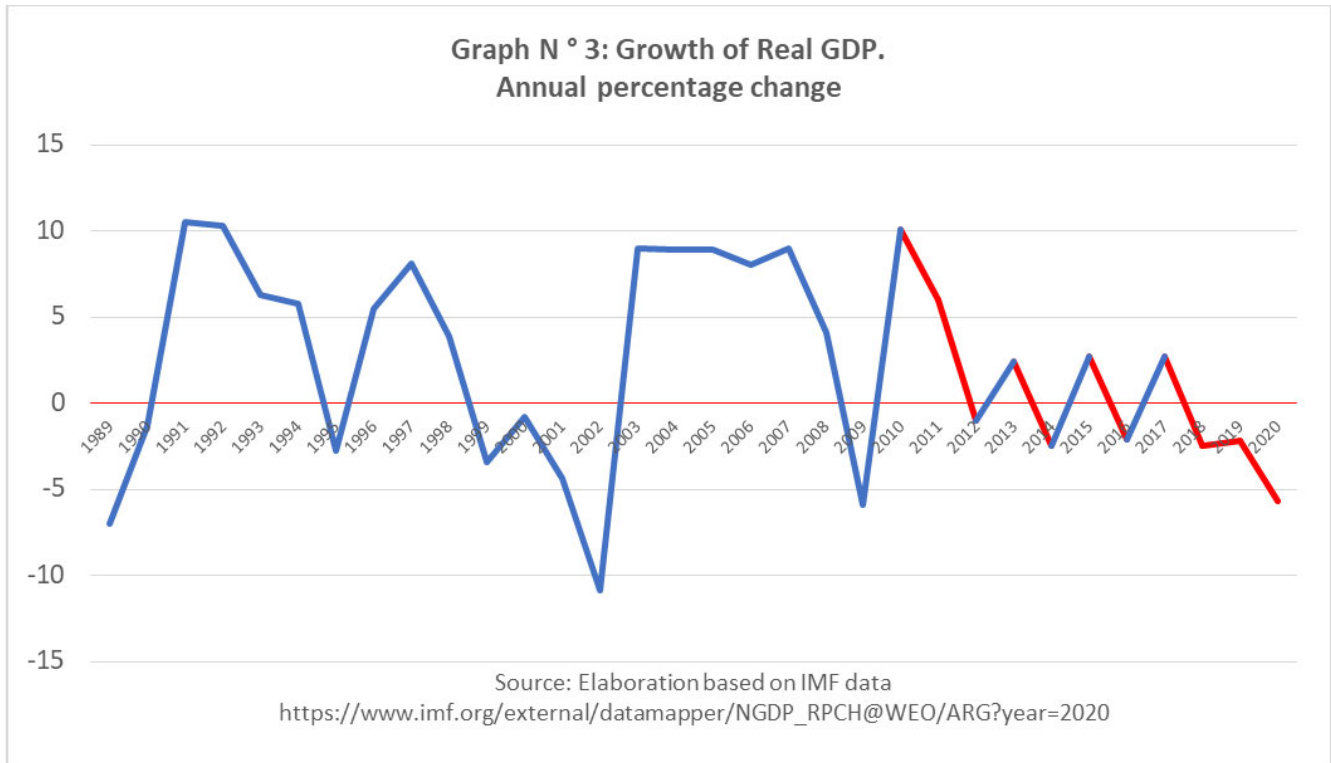
DATE [Event]	VALUE
10/12/2007 [End of the government of Néstor Kirchner. Transfer of the presidential mandate to Cristina Fernández de Kirchner]	45.566
10/12/2015 [End of the government of Cristina Fernández de Kirchner. Transfer of the presidential mandate to Mauricio Macri]	24.862
11/01/2018 [The maximum value registered in the first two years of Macri management]	63.906
07/06/2018 [Macri government announces agreement with the IMF, after the fall in reserves]	49.851
09/04/2019 [The maximum value recorded, after aid received from the IMF]	77.481
02/09/2019 [(Communication "A" 6770/2019), establishment of exchange control (soft) for operations over US \$ 10,000 / person / month]	53.146
28/10/2019 [(Communication "A" 6815/2019), establishment of exchange control (rigid) for operations over US \$ 200 / person / month]	43.406
10/12/2019 [End of Mauricio Macri's government. Transfer of the presidential mandate to Alberto Fernández]	43.785
19/03/2020 [Fernández decrees the "ASPO"]	43.925
29/06/2020 [Almost one hundred days after the implementation of the "ASPO"]	43.201

The Beginnings of the Fernández Administration: Economic Crisis, Pandemic, and Prolonged Isolation

When Fernández assumed the presidency, in December 2019, the Argentine economy was facing prolonged stagflation – which had lasted for almost a decade. That process was characterized by short cycles of growth and recession (stop and go style), but with a clear decreasing trend that deepened in the last year and a half of Macri's management.

COVID-19 and the Economic Crisis in Argentina

Written by Priscila Palacio



As aggravating factors to this situation of prolonged stagflation and increased external indebtedness, other vulnerabilities must be added, which also evidence a structural nature in the Argentine economy (from several years). Among them, we point out the recurrent problem of the fiscal deficit, the high tax pressure on the formal sector of the economy, the presence of a significant informal sector, the high levels of poverty, and the relevant portion of the population that depends on social plans. Besides, we find the prevalence of unemployment and underemployment, the dependence on commodities' exports, and the constant depreciation of the national currency that occurred in the

COVID-19 and the Economic Crisis in Argentina

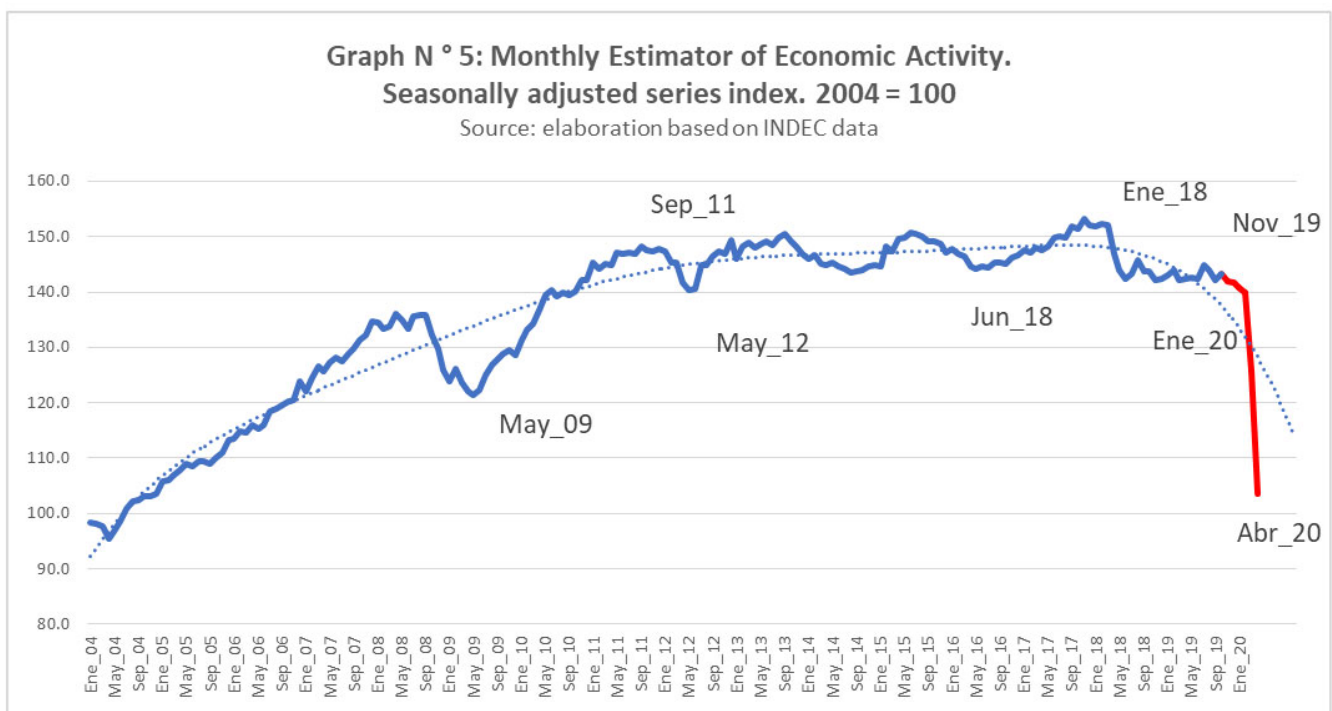
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second decade of the twenty-first century. Also, from a social point of view, it could be added a great ideological and political polarization of Argentine society (called “rift”), that has been explicit for more than a decade.

In that context, the rise of Fernández to power – in a formula that includes former President Cristina Fernández de Kirchner, has been applauded by some sectors and generated concern in others. Some distrust the president’s leadership and his margin of maneuver to implement policies that could provoke resistance in the “Kirchneristas” sectors. This, because Fernández led an alliance made up of various political parties but orchestrated under the initiative of Cristina Fernández.

On the other hand, although the Fernández’s campaign slogans raised the flag “we know what we need to do to make Argentina stand up” (own translation), the investment climate has not been favorable in the first months of his administration. A few days after taking office, Fernández – with his minister Guzmán, sent to Congress the Project of the Law of Social Solidarity and Productive Reactivation in the Framework of the Public Emergency N° 27.541 (Ministry of Productive Development of Argentina, 12/21/2019). In said legislation, the government maintained the rigid exchange control established since the end of the Macri administration and created a new tax, so-called PAÍS (Tax for an Inclusive and Solidarity Argentina), which falls on purchases and payments made by Argentine residents in foreign currency. Likewise, some withholdings on exports were increased and, also, the aliquots of some national taxes. Relative to foreign debt, the government launched its renegotiation proposal, holding, at first, a position that appealed to the country’s insolvency and the need to subject payments to the resilience of the national economy.

As the monthly estimator of economic activity shows (Graph N ° 5), in the first months of Fernández’s administration, the economy went on its downward trajectory – even before the quarantine. Although the government managed to lower interest rates to a certain extent, they continued to be high, which has restricted productive investment and consumption capacity. Added to this, it has evidenced the accelerated depreciation of the currency after the implementation of the PAIS tax, which, in rigid exchange control, not only affects inflation but continues to favor the speculation (a phenomenon that, up to now, Fernández administration failed in removing). This process, historically, has been detrimental to the investment and productive development of the country.



So when, in mid-March 2020, Fernández established mandatory isolation at the national level, some analysts praised that decision, considering that Argentina would be an example of managing the pandemic at the regional level. In

COVID-19 and the Economic Crisis in Argentina

Written by Priscila Palacio

several speeches, Fernández set out the government's position as a dilemma between defending health or the economy, noting that his government has inclined towards health, even at the cost of the economy is the most affected sector.

Even so, more than a hundred days after the implementation of the restrictions to circulate and, having registered marches and countermarches in the opening of local shops, in early July, the government re-implemented the restricted quarantine phase for the AMBA area (for about two weeks). The more than three months of paralysis that the domestic economy had to endure have impacted on a severely weakened economy. As the monthly estimator of economic activity shows, in the second two-month period of 2020, the economic fall has been resounding. Argentina has plunged into economic stagnation that, according to some estimates, would lead to a historical contraction in some sectors – such as industry or construction (which have a significant multiplier effect).

Conclusion

The government has implemented some palliative measures, including: the establishment, as of May 2020, of a subsidy (IFE-Emergency Family Income voucher) of 10,000 pesos per month (equivalent to US\$ 100 – current official quotation) for low-income sectors that do not receive remuneration due to the compulsory isolation; the Emergency Assistance Program for Work and Production (ATP) (Official Gazette of the Argentine Republic (04/20/20), Decrees 376/20), which consists of assigning one or more of the following benefits: postponement or reduction of up to 95% of the payment of employer contributions; complementary salary paid by the National State for workers in dependency relation on the private sector; zero-rate credit for people attached to the “Monotributo” and self-employed workers; an economic unemployment benefit – between 6,000 and 10,000 pesos; but also, requirements were established for access to these benefits, such as: that companies must justify the substantial reduction in their turnover; that they must have a workforce of employees with a dependency relationship, etc.

However, many of these measures were insufficient to counteract the slump and stagflation facing the Argentine economy in the second quarter of 2020. Furthermore, there is a probability that inflation could accelerate in the coming months when prices and rates that are currently frozen readjust. According to a sampling carried out by PwC Argentina on more than one hundred SMEs, 92% considered insufficient the benefits granted by the Argentine government during compulsory isolation (even though 57% of the companies surveyed said they had accessed the ATP program).

On the other hand, regarding the renegotiation of the debt, after having made three previous offers, the government improved the conditions for the country's creditors. In early July, Minister Guzmán officialized a new proposal that – up to now, has been accepted by a portion of the bondholders. Negotiation is still underway, but some estimate that Argentina would be close to closing a deal (despite the emerging difficulties).

However, even under the scenario of a possible foreign debt agreement and the gradual normalization of the economic activity (after the prolonged isolation), the outlook for the Argentine economy for the second half of 2020 is gloomy. The current and the structural situation are critical, which suggests social conflicts if the government fails to contain the crisis in the medium term. Not only is the resilience (rebound) of the national economy conditioned by the closure of thousands of SMEs (CAME, 06/20/20), and increased formal and informal unemployment – exacerbated by isolation. The problem is that encouraging policies for productive investment is not envisaged. Even because of the tightening of exchange controls and the high tax pressure, several companies decided to move to neighboring countries.

Therefore, not only is the economic situation complex, but the social and political situation adds more instability. To the enormous increase in poverty that Argentina will register after the policies implemented to counteract the spread of COVID-19, we must add the dramatic fall in the purchasing power of employees and the increase in the indebtedness of families. Likewise, the speculations generated by the possible existence of a double command makes the coordination of policies by the National Executive more difficult.

Finally, the crisis generated by the COVID-19 has scarce backgrounds in contemporary world history and, none in

COVID-19 and the Economic Crisis in Argentina

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periods of relative international stability. Furthermore, it will have an impact on the capitalist production system, provoking a significant slowdown or fall in many economic sectors, at least in the short and medium-term, as well as the need for the reconversion of many others for the coming years. In the case of Argentina, this crisis aggravated the long impasse that its economy faced for about a decade and will cast a cloak of uncertainty on the political future of the Fernández administration, looking to the parliamentary elections of 2021.

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