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FEATURED Q&A

How Will Gov't Interventions Affect Argentina's Economy?

Q Argentina's government earlier this month set new price controls on nearly 200 supermarket items, including bread, milk and meat, in response to inflation, which private economists estimate to be approximately 25 percent and rising. How will the price controls and other recent government measures, such as its tax hike on credit-card purchases made abroad, affect the economy? Which businesses and sectors stand to lose the most from new measures put in place in recent months? How will demands for higher wages by public-sector employees, such as teachers and police officers, likely play out this year?

A Cecilia Nahón, Argentina's ambassador to the United States: "The following focuses on outlining and clarifying the goals of a price agreement that was recently launched in Argentina. On Jan. 3, the government of Argentina, in conjunction with the private sector, launched a voluntary price agreement for a 'basic basket of goods' comprised of 100 products (and 194 prices) including food, beverages and cleaning supplies, among other items. The basket includes the key products to cover the population's basic needs. The agreement represents a voluntary commitment assumed by 10 national supermarket chains and 65 suppliers. It is valid for one year and will be reviewed on a quarterly basis according to cost variations within the product's value chain. It is not a price freeze policy. The goal is to provide predictability, stability and transparency in the process of price formation by providing a benchmark basket of consumer products so that the population can make informed choices. By primarily targeting price dispersion, it provides consumers, especially those with lower purchasing power, with valuable tools. The products included within this agreement are clearly identified by a legend that reads 'Precios Cuidados' in all participating stores. The only ones that stand to lose from this policy are speculators and

Continued on page 3

World Court Set to Rule on Peru-Chile Maritime Dispute

The International Court of Justice is expected to rule Monday on a long-running maritime dispute between Peru and Chile. Peruvian Finance Minister Luis Miguel Castilla said the ruling will consolidate the countries' bilateral relationship. See story on page 2.

File Photo: TV Perú.

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NEWS BRIEFS

Mexico Launches Tax Probe of Seven Multinational Companies

The Mexican government is investigating seven multinational companies to determine if they evaded taxes, Oscar Molina, who heads audits of major companies at Mexico's tax collection agency, told Reuters on Thursday. Most of the firms are American and the group includes some Fortune 500 companies in the automotive, mining and retail sectors. Mexico has flagged 270 companies as possibly avoiding taxes as part of an effort of the Group of 20 nations (G20) to crack down on "aggressive fiscal planning," where companies exploit differences in tax policies across countries to decrease their taxes.

Ecuadorean Airline Suspends Flights to Venezuela

Ecuadorean airline **Tame** has suspended flights to Venezuela, saying the Venezuelan central bank has not paid the company since April 2013 and owes it $43 million for past ticket sales, BBC News reported Thursday. Some 80 passengers were stranded at the Quito airport on Thursday. Foreign currency controls in Venezuela make it hard for foreign companies to repatriate money made on ticket sales in Venezuela, and the government is estimated to owe some $3 billion to airlines.

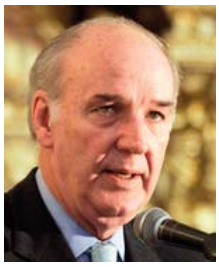
Nestle to Build Two New Factories in Mexico

Switzerland's **Nestle** said today that it plans to construct two new factories in Mexico and invest $1 billion there over five years, the Associated Press reported. The food and drinks maker said it will build a baby-food factory in Ocotlán in Jalisco state and a pet-food plant in Silao in Guanajuato state. Mexico is Nestle's sixth-largest market globally.

Political News

World Court Set to Rule on Chile-Peru Maritime Dispute

The International Court of Justice in The Hague is scheduled to rule Monday on a border dispute that dates back more than a century, Reuters reported. The United Nations court plans to rule on Peru's claim over 38,000 square kilometers of Pacific Ocean waters that Chile controls, in addition to a claim over a portion of international waters. The case has its roots in the 1880s War of the Pacific, in which Chile took territory away from Peru and Bolivia. The war resulted in Bolivia becoming landlocked. Bolivia has also filed a case against Chile at the World Court, demanding access to the ocean. In the case up for a ruling on Monday, Peru has argued that its maritime border has never been adjusted, though Chile maintains that treaties signed in the 1950s establish its boundaries. "With The Hague ruling, we'll define our maritime border with Chile, and then all of Peru's terrestrial and maritime borders will be sealed forever," said José García Belaunde, who was the Peruvian foreign minister when the case was taken to the World Court, Reuters reported. A Peruvian fishing industry body has said that fishing in the disputed area that Chile controls is worth some $200 million annually. However, bilateral trade between Chile and Peru is worth more than $3 billion after increasing by nearly five times between 2002 and 2012, Reuters reported, citing Peruvian customs data. Chile has approximately $12 billion in investments in Peru and is the Andean country's largest trading partner in the region. In addition, many Peruvians live in Chile and send remittances that have become an important part of Peru's local economies. The World Court's expected ruling "is an important step because it consolidates our relationship," Peruvian Finance Minister Luis Miguel Castilla told local broadcaster RPP, Reuters reported. "There will be a much stronger country-to-country effort." Chilean President Sebastián Piñera, who leaves office in March, has said his government would defend Chilean interests. However, he added that Chile would work to "ensure continued collaboration that is in the interests of both countries."



García Belaunde

File Photo: TV Perú.

Economic News

Argentina to Relax Foreign Exchange Controls After Peso's Plunge

Argentina's government will ease its foreign exchange controls by reducing the tax rate on purchases of dollars and will also allow Argentines to purchase the U.S. currency for savings accounts, BBC News reported today, citing cabinet chief Jorge Capitanich. The new measures are to take effect on Monday. The Argentine peso on Thursday plummeted 11 percent against the dollar, its sharpest decline since the South American country's financial crisis in 2002. Between Wednesday and Thursday, the peso fell 16 percent against the greenback at the official exchange rate, the Associated Press reported. At the close Thursday, the peso had declined to 8 pesos to the dollar. On the black market, the Argentine currency fell to 13 per dollar. Argentina's central bank had been intervening to support the peso, but abandoned that policy amid dwindling foreign reserves, the AP reported. "There was a first sign of this change on Tuesday because the central bank didn't show up [to intervene] until midday, and on Wednesday and today it just disappeared from the market," Juan Pablo Ronderos of economic consulting firm **abeceb.com** told the AP.

The peso's decline was the sharpest since 2002.

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Canal Authority, Consortium to Continue Talks At Least Until Feb. 1

The consortium of contractors that has been holding talks with the Panama Canal Authority this week over cost overruns in a project to expand the canal said Thursday the parties had agreed to a new negotiation protocol aimed at settling the dispute. **Grupo Unidos por el Canal**, or GUPC, the consortium formed by **Sacyr** of Spain, **Salini-Impregilo** of Italy, **Jan De Nul** of Belgium and **Constructora Urbana** of Panama, said in a statement that the parties agreed to continue talks until Feb. 1, a deadline that could be extended with continued progress, according to people familiar with the negotiations. More than $1 billion in additional funds may be needed to complete the canal's expansion, which is about 70 percent complete.

De Lima

File Photo: Panamanian Gov't.

GUPC, which says "unforeseeable conditions and costs" would bring the project to a halt without more funds, also said Thursday it has proposed a new financing concept that has the involvement of insurer **Zurich**. Panamanian Finance Minister Frank De Lima told Agence France-Presse Wednesday that the canal expansion project will be finished in 2015 "with or without" the consortium. However, others say the project could be set back by years if the companies pull out. "If GUPC was to stop work now, the canal would be finished, but not in 2015—more likely in 2018, 2019, or 2020," a panel of independent advisors on the project's Dispute Adjudication Board wrote last month in document cited Wednesday in a Reuters report. Companies and governments around the region have been watching the dispute closely. With initial plans underway to create a new canal across the isthmus in Nicaragua, and multi-million-dollar port expansions being planned to handle wider ships in U.S. cities such as Savannah, the stakes for Panama, which is counting on millions of dollars in new tolls and fees, in completing the project quickly are high.

Featured Q&A

Continued from page 1

price makers who abuse consumers through deceptive maneuvers, while consumers and the majority of players in the value chain will clearly benefit. This agreement is one of the tools aimed at advancing a broader policy objective: to strengthen the ongoing growth process with social inclusion in place in Argentina since 2003."

> "The only ones that stand to lose from this policy are speculators and price makers who abuse consumers ..."
>
> — *Cecilia Nahón*

A Delfina Cavanagh, associate director at the sovereign and international public finance group at Standard & Poor's in Buenos Aires: "The price controls increase informality and kick the can of structural adjustment down the road. However, as time passes and the root of inflationary problems and foreign exchange pressures continue without being addressed, the kick goes shorter and shorter. The Argentine government has been conducting these so called 'price arrangements' since the beginning of President Fernández de Kirchner's first term. Price controls work for a fairly short period of time, but do not work for really tackling inflation. In the same line, the measures implemented to discourage dollar purchases, to control the fall in reserves and the gap between the official and the parallel rate for foreign exchange, have little impact in the medium and long terms. The government is relying on mitigation measures instead of addressing the demand and supply causes of inflation and solving the real pressures in the foreign exchange market, which come from declining reserves driven by macroeconomic instability and lack of predictability regarding medium-term policies. The middle and lower classes stand to lose the most, as their purchasing power begins to rapidly deteriorate. At the same time, the fiscal balances at the national and provincial levels are also weakening as tax burdens are already at historically high levels in a context of low economic growth. This diminishes the fiscal margin to continue granting wage increases that could return the purchasing capacity to public employees. Argentina will likely suffer the eighth consecutive year with double digit inflation. In this context, unions are demanding constant wage increases.

> "Price controls work for a fairly short period of time, but do not work for really tackling inflation."
>
> — *Delfina Cavanagh*

After the events of last December when several provincial police went on strike demanding higher salaries, some provinces have granted increases to security forces, putting further pressure on their already weak budgets."

A Felipe Yapur, journalist at Radio Nacional and Tiempo Argentino: "Argentina's government is experiencing a new phase of speculative attacks concentrated in sectors that promote the local economy. These attacks are expressed through escalating inflation and runs on the illegal market for dollars, which leads to delays in liquidations of exports for large agricultural producers, drying up the legal exchange market. These speculative attacks seek to destabilize the current government, which is entering its final two years. At the same time, it is freezing

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Featured Q&A

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the political process of the state's strong presence in controlling the economy. The Kirchner administration promotes the reindustrialization of the productive sector, which generates sources of jobs and a process of import substitution. The government's opponents reject this model, which has generated large dividends for them, and prefer the neoliberal pattern that dominated the country in the 1990s and is now applied in the Eurozone to the detriment of the majority of its population. For this reason, and aided by large media groups, they have provoked inflation and runs on the exchange market as a mechanism for generating a strong devaluation that only hurts most Argentines. One response from the government was the recent accord on prices involving about 120 products, which the government reached with the major domestic and foreign supermarket chains; it is still too early to evaluate its effects. The disputes between the competing economic models will not come to an end, at least not before the 2015 presidential election."

Miguel Kiguel, executive director of EconViews in Buenos Aires: "While most of the concerns in Argentina have recently centered on the evolution of international reserves, as they continue to dive at a worrisome pace, inflation has become a second worrisome issue. The rate of inflation increased slightly in November and then in December and January has been running at more than 3 percent per month. This increase in part reflects that inflation was somewhat repressed during the tenure of Secretary of Commerce Moreno through informal price controls while it was somewhat contained by the slow rate of depreciation and an agreement with the unions to set ceilings on wage increases. Moreno's departure, the increase in the rate of depreciation following the October elections and the police revolts in December in many provinces that ended with wage increases ranging between 40 and 80 percent have changed the scenario. Today, the government lacks a monetary instrument or any other type of signal to anchor inflation expectations, and it is not clear that it can come up with one any time soon. This means that the recent rise in inflation will be difficult to reverse without a change in policies. The government is going back to what it knows, which is to impose price controls, even when experience shows that they don't work. Monetary policy is becoming slightly tighter, as the central bank has been raising interest rates, but so far it has been too little and too late. To make things worse, the government now faces additional trade-offs because it needs smaller subsidies to reduce the fiscal deficit and a much larger depreciation of the peso to address the drop in international reserves, two adjustments that tend to lead to higher inflation."

Daniel Artana, chief economist at FIEL in Buenos Aires: "Price controls have failed in the recent past and will fail again. The relevant question is whether they will have no impact on inflation or if they will create a scarcity of goods. The tax on credit-card purchases is a one-sided devaluation that is an inferior solution because it does not include all transactions. Economic activity is decelerating and we are projecting a moderate recession in 2014 with no winners. The negotiation with teachers is crucial for the provincial fiscal accounts. In the end, sub-national governments will put pressure on money printing if there is another fiscal slippage."

The Advisor *welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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