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TANGO CANCION



letter: 2023, April
Samba or Tango?



CARTOLA

Part 1

The Samba's (dis)harmony

In our last newsletter, entitled “There Shines a Star... a Falling Star?”, we focused on understanding the political-economic restrictions faced by Lula’s fresh new term¹.

We understand our president is in a complex economic policy decision-making environment. On the one hand, he should consider the rule of thumb of adjusting the federal budget in the first two years and only then loosen spending in the final two years of his term, as to end it in an upward economic trend. On the other hand, an economic slowdown in the short term, resulting in an increase in unemployment, demanded by inflation convergence, puts his governance at risk right from the get-go, due to his already fragile popularity.

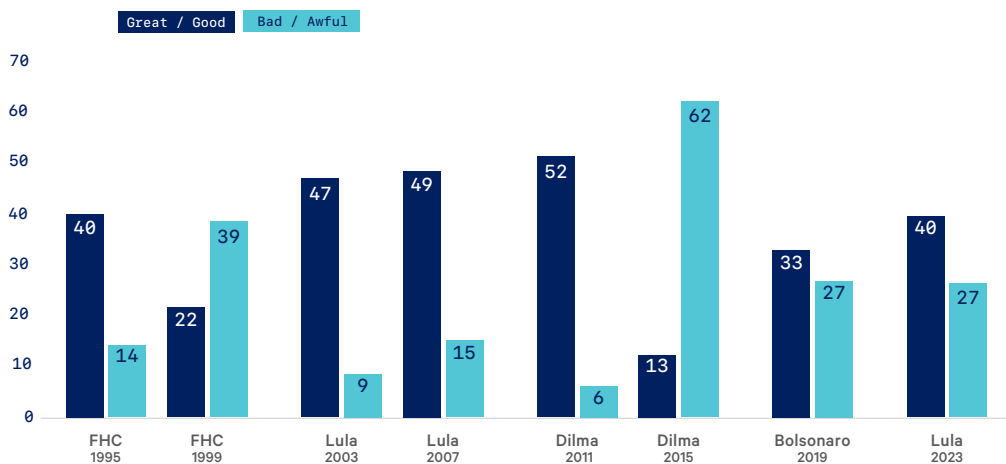
The current political restrictions and dangers are important factors that limit the natural strategy for a term’s onset, which is fit for the current

1 PDF link: [Feb. 2023 – There shines a star... a falling star?](#)

economic cycle, that is, manage a controlled activity slowdown, capable of bringing inflation back to its target with the least possible economic cost.

The elections' results were tighter than ever, and a significant part of society is self-proclaimed "conservative". This new political attitude is yet another challenge for President Lula, who begins his term with low approval ratings and rejection ratings similar to that of former President Bolsonaro in the first months in office. Therefore, there ought to be political restraint by Lula in managing the economy.

Administration's Rating after first 3 months - Ipec/Datafolha Average



Source: IPEC (Research Intelligence and Strategic Consultancy), Datafolha (Group Folha's polling institute), Mar Asset

Approval ratings are a relevant bargaining chip within the executive and legislative branches' relationship, for a popular president possesses more political capital and leverage in negotiations with Congressmen. Increasing the administration's popularity is a priority early into this office, given it would improve governance in a politically turbulent environment.

The administration believes it can increase its popularity by increasing spending and promoting economic and employment growth. However, the high levels of public debt and the need for fiscal responsibility impose limitations on this strategy. Spending expansion without a sound fiscal balance tends to provoke asset price crises, since investors would call the fiscal imbalance in advance, seeking protection in dollar assets and selling government bonds, thus raising future interest rates.

Even if higher spending is carried out, the most troubling factor against faster growth and better popularity ratings as of now is the stage where we find ourselves within the economic cycle. Brazil is an economy with high gross debt level, high inflation and unemployment below NAIRU (Non-Accelerating Inflation Rate of Unemployment). These conditions tend to transform new economic stimuli into more inflation and not into growth.

The current inflationary process in Brazil demands economic slowdown and unfortunately so, higher unemployment. This demand led the Central Bank of Brazil (BCB) to elevate the *Selic* (basic interest rate) rate to 13.75% a year.

While in the United States the economic debate over controlling inflation is focused on the need for either a “hard landing” or a “soft landing”, in Brazil, both the markets and the government expect the disinflation process to occur with minimum economic impacts. The Focus survey, for instance, foresees growth below potential; 0.90% in 2023, but estimates that from 2024 on, growth will return to its potential; between 1.5-2%.

Unlike the US, where the disinflation process is made easier by target-anchored expectations, Brazil faces a higher cost in terms of economic activity, due to the unanchoring of such expectations.

We believe that most of this unanchoring results from the perception that the Brazilian government would not be up for promoting the necessary economic slowdown to bring inflation back to its target. This perception is aligned with the political priority of accelerating economic activity in the short term.

The longer the government takes to acknowledge the need for respecting the economic cycle, the higher the cost, in terms of product, is needed in order to control inflation and rebalance the economic variables.

The recurring challenge of tax collection increase

The public balance sheets' equilibrium has been a constant challenge for Brazil in the last decades. Since Fernando Henrique Cardoso's administration, who implemented one of the highest tax hikes ever, Brazil has dealt with repeating fiscal crises. The high point of this tense environment culminated in former President Dilma Rousseff's impeachment process.

The Bolsonaro administration also faced fiscal challenges. Back then, the Minister of Economy, Paulo Guedes, shared the same diagnosis with his predecessor, Henrique Meirelles, that sorting out public finances would be achieved by reducing public spending and implementing structural reforms.

Bolsonaro's administration believed the State apparatus itself would be the leading source of increase in primary result, be it by current expenses reduction, privatizations or dividend yield increase from State-owned companies.

Reducing the size of the State aimed at stabilizing the debt/GDP ratio and gaining economic efficiency by the crowding-in effect. In this scenario, the private sector would fill in the spaces left behind by the public sector, driving economic activity and fiscal sustainability.

By and large, former Minister Paulo Guedes would symbolically see the State apparatus and its employees as the main adversaries against his fiscal policy implementation.

Lula III presents a different diagnosis: in order to provide a better quality of life to the population, it is necessary to promote more social spending and increase public investment, so as to drive the economy toward a new phase of growth.

A fiscally responsible increase in spending faces the same challenge as the increase in tax collection that previous governments have dealt with. Recent measures announced by the Administration indicate that the exceeding tax revenue shall come from effective taxation increases.

Since higher taxation is extremely unpopular amongst the broader population, and improving popularity is paramount for the government, the solution falls upon taxation on specific private sectors, big corporations

and economic elites. By doing so, not only would there not be a drop in approval ratings, it could eventually lead to an increase, as a reflection of the Robin Hood concept.

That is to say, while former Minister Paulo Guedes deemed the State apparatus and its civil servants political adversaries against his fiscal agenda, Minister Haddad aims at the private sector to generate the necessary additional tax revenue.

In this newsletter, we will not detail the recently presented fiscal framework, but will do so on another occasion². We consider that the great novelty here is the schedule for primary surpluses to be achieved in the next years, and we understand that the main conflict facing the current administration will be fought in Congress, debating over tax boosts on the private sector, which is vital for its fiscal objective and political survival:-

This fight, recently announced by the administration, involves 2-3% of GDP (R\$200-300 bi.) to be withdrawn from big corporations' and economic elites' profits.

The aftermath of the dispute to be led by Congress in the next months will largely determine the current presidential office's economic and political viability.

The first signs of how the government is sailing this rough sea

Given the restrictions this newsletter has discussed, we have dedicated ourselves to understanding the first signs of how the government will react to a highly complex environment and with so many restrictions for the administration's ratings and economic policy.

One decision already seems clear: there will be no tolerance for activity slowdown or unemployment increase.

2 PDF link: [Nova estrutura fiscal - palha, madeira ou concreto?](#)

President Lula has made it clear in his statements that his initial priority is getting the country back on the track of growth and reducing unemployment, and for this, government-spending expansion is a necessary means.

By making such decision, the government puts the BCB in a tough spot, since the Central Bank now faces a battle for inflation convergence by himself, while the government spends more. So, on the one hand, the BCB tightens monetary conditions by keeping the *Selic* rate high, but on the other hand, the government expands public spending.

Even so, the government has opted for a combination of public spending acceleration with some fiscal anchoring. It seeks to advance economic activity, which hinders the process of disinflation, but does not immediately compromise the public debt ratio.

In relation to this narrow path, we see a first and symbolic decision, represented by the process of re-taxing gasoline, that is, the termination of the previous tax break in place. There was a consensus between government and market that re-taxation was due and necessary, once the loss of revenue from tax breaks was far too great. Re-taxing a basic price such as gasoline is capable of significantly affecting the government's popularity, a variable that, as pointed out earlier, is vital for its governance.

The final decision was a partial re-taxation, mitigating a steeper gasoline price increase and its impact on popularity. However, in order to keep the promise of fiscal responsibility, they looked for a new source of tax revenue by taxing oil exports. So, two objectives were achieved: the tax gap generated by gas subsidies was recouped and the impact on popularity was attenuated.

What may look like a reasonable solution at first sight represents a structural approach towards a problem that will repeat itself throughout this term.

Increased fiscally responsible spending requires more tax collection.

The greatest tax collection could come from a stronger GDP growth (limited by the current economic cycle stage, which already depicts an exhausted economy) or increased tax rates.

Tax rates increase may be done in horizontal fashion on the whole population (gasoline increase, *CPMF* – Contribution on Financial Transaction, *PIS/COFINS* - Contribution for the Financing of Social Security etc.) or in sectorial fashion, hiking taxes on specific economic sectors.

By re-taxing gasoline, the government trekked an intermediate path, but has signaled its willingness to tax productive sectors as a source of new revenue.

The perceived advantage of boosting the tax burden by means of sectorial taxation is the lesser impact on the government's popularity ratings.

By releasing the novel tax framework, this logic concerning the political-economic structure was made clear.

The quest for a 2%-3% of GDP additional tax revenue

It is important to acknowledge the Government Economy's team ability to communicate up to this point. Little information leaked to the press during the elaboration of the new framework. The information released was carefully tailored and effectively anchored the market with the only available data: the future schedule for primary surpluses.

This schedule immediately put off the more pessimistic scenarios and surprised the market in a positive way. Even if the details on how to fulfill this schedule were not explained, there was a strong positive reaction from asset prices.

Once the path to surplus was revealed, it illustrated the size of the challenge relative to tax collection increase and, considering popular opinion, the size of the burden levied on the private sector.

By adding the tax collection intentions since the beginning of the government, including the post-Transition *PEC*-(Constitution Amendment Bill) statement and the intentions stated along with the novel framework, we have about 2.5% of GDP, approximately R\$250 bi., to be recurrently deducted from the economic establishment's profits.

Measures proposed to increase tax burden

(R\$, bi. and % of GDP)

Measures	2023		2024	
	R\$ bi	% of GDP	R\$ bi	% of GDP
Permanent Revenue Actions in 2023				
ICMS ¹ credits	30	0.28%	39.82	0.35%
PIS/COFINS on Financial Revenue	4.4	0.04%	6.01	0.05%
PIS/COFINS on fuels	28.88	0.27%	54.51	0.47%
Permanent effect from incentive to litigation reduction within CARF ²	15	0.14%	15.45	0.13%
Permanent effect from incentive to spontaneous tax waiver	5	0.05%	5.15	0.04%
CSLL ³ e IRPJ ⁴ on ICMS benefits	45	0.42%	108	0.8%
Taxation of e-commerce	4	0.04%	9	0.1%
Taxation of e-betting	7.5	0.07%	18	0.1%
Extraordinary Revenue Actions in 2023				
Extraordinary incentive to litigation reduction within CARF	35	0.33%		
Extraordinary incentive to spontaneous tax waiver	15	0.14%		
Primary revenue with assets from PIS/PASEP ⁵	23	0.21%		
Total	212.8	1.99%	256.5	2.09%

Source: Marasset, ¹ICMS (state-level merchandise tax), ²CARF (Administrative Board of Tax Resources), ³CSLL (Social Contribution on Net Income), ⁴IRPJ (Company Income Tax), ⁵PIS/PASEP (Program of Social Integration/Civil Servant Asset Formation Program contribution).

With the partial re-taxation of gasoline, it became evident that the big Brazilian companies and the economic elites are the opponents the current government will have to face.

Former Minister Paulo Guedes made the mistake of announcing the privatization of all State-owned companies at the start of the last term in 2019, which assembled the civil servants' political force against him. Likewise, Minister Haddad seems to have adopted a similar strategy in announcing beforehand the intention to raise taxes on several economic sectors, inciting their political union and organization against the measures to be submitted by the administration.

The next step is to fight it out in Congress.

The private sector has already come to understand this scenario and is organizing itself by means of lobbyists and use of its influence on Congress and society to curb these government-led tax hikes intentions.

Given the frailty of popularity and deep societal division, that imply in a structural opposition to the current administration, it seems to us that a strong and well-organized private sector has a good chance of obtaining important victories within Congress.

Up to this moment, politicians' silence on the matter seems strategic. Congressmen, looking out into a cloudy horizon, are waiting to better position themselves in relation to their individual political strategies.

The dispute for public resources and the elites is as old as democracy itself. The democratic challenge is to reach a middle ground of powers between elites and the population, not only ensuring the elites' resources are allocated towards improving the lives of the broader population, but also stimulating these elites to continue producing wealth for future allocations.

The risk of a democratic model lies both within elitist governments that ignore the needs of the population, generating social and political unrest, and popular governments that excessively confiscate wealth and undermine economic growth, impoverishing the economy with time.

This dispute is more often than not noisy and volatile, with presidential popularity and social perception that the government makes good use of public resources acting as a stabilizing factor.

Prognosis

Should the government suffer a loss, its fiscal framework, strongly dependent on a greater tax burden, would be dismantled, while revealing a lack of structural capacity to implement its agenda within Congress.

The two major legislative agendas at this office's onset, the novel fiscal framework and the tax reform, are facing the same political actors as adversaries. Therefore, the result from a dispute could indicate the other's result.

Two losses in important topics during the so-called "honeymoon" period would alter the perception concerning the structure of power and the national agenda.

In a lost battle scenario, we would probably see strong volatility and worsening of asset prices in the months ahead, up until new political stability is reached – possibly by ministerial reform, granting more power to the winners. Another possibility is that of an environment outlined by rhetorical disputes between the Executive and Legislative branches, in which some stability would be forged, with sights set on the upcoming elections for House Speaker and Congress President, and especially the municipal elections in 2024.

This environment would do well as preparation for the next presidential election, and, at some point in time, the markets would recover, due to negotiations and projections for a new presidential cycle.

However, if the government does come out victorious in Congress and the tax hikes are approved, the markets would react positively in the short term, due to the perception that fiscal responsibility was achieved – despite sharp drops in stock prices from the companies most affected by the heavier tax burden.

In this scenario, spending expansion would keep adding upward pressure on inflation and the economic slowdown would insist on following the idle capacity exhaustion cycle, but the intolerance to the economy cooling down would also persist, eventually leading to a new set of stimuli. Upon each new fiscal frustration, new taxes on specific private sectors would be considered. The increase to the tax burden, that would have seemed to be a one-time adjustment, could become a repeating source of new revenue, and the short-term improvement would eventually be replaced by a deep-seated worsening of prices until the new political cycle.

Part 2

Tango crossing Samba

Since several social-economic conflicts take us back to the past, the emergence of this new information is conducive to analyzing the Argentinian case.

Very often, we find comparisons between Brazil and Argentina to be simplistic and shallow. However, upon the current scenario, we deem it important to review the Argentinian history, since the country chose to finance public policies by increasing taxation on specific sectors in the last decades.

The big difference from recent Brazilian economic policy in contrast with Argentina is in the early 2000s.

While Nestor Kirchner was elected to undo all liberal reforms implemented by Carlos Menem in the 1990s, Lula, in the final stretch of the Brazilian elections in 2002, wrote a letter to the Brazilian people stating he would not carry out abrupt changes in economic policy that would jeopardize inflationary control.

Lula was awarded a presidential office to upkeep his predecessor President Fernando Henrique Cardoso's achievements and advance into wealth distribution, while Argentinians believed that the liberal economic reforms carried out in the 1990s were to blame for the economic collapse of 2001, granting Kirchner a blank check to devise a future for Argentina.

In 2022, president Lula received an ambiguous message from the ballots. The election was practically a tie, with rejection on both sides playing a key role. Lula won with support from voters more likely anti-Bolsonaro than pro-Lula, which points to lesser tolerance for a very left-leaning administration.

This electoral parity means low popularity at the start of his term, generating anxiety and haste to implement expansionist economic measures.

This new opposition brings balance to the forces between left and right, restricting the available spaces to the new government and pressuring the Lula administration to prioritize carefully his approval ratings.

We believe an “Argentinian” scenario in Brazil to be unlikely, given that we are able to see the unfavorable position the current government is in this direct dispute against the establishment.

Something similar to the decisions from Cristina Kirchner’s first term, but incipient, took place during President Dilma Rousseff’s presidential term. Dilma faced a strong inflation spike, due to an imbalance between supply and demand after years of strong Brazilian GDP growth, when output gap was eaten up. Like Cristina, Dilma did not want to promote an organized economic slowdown. In order to face soaring prices, she opted for freezing prices of items sensitive to the population, government-spending increases to elevate product supply and fiscal maneuvers to improve public balance sheets.

At that time, the risk of “Argentinization” of our economic policy was high, and we did not know quite well the degree to which Brazilian society had an ideology, not even what would the impact of economic deterioration and inflation increase to presidential popularity be, as well as the society’s capability to organize itself against bad government decisions.

However, differently from the high popularity of Cristina’s left-leaning government and augmented influence over the Legislative and Judiciary branches, in Brazil there was a swift corrosion of Dilma’s ratings and a complete withdrawal from Congressional support. This led to her impeachment and a following correction of the path in Brazilian politics and economy.

Therefore, in face of economic excesses, Brazilian society reacted differently from Argentinian society.

Argentina's history

To understand better these differences, it is crucial to contextualize the recent history of our neighbor's economy, with a view to duly establishing the meaning of the expression "Argentinization" of the economy, so often used in our country.

To whom may socioeconomic history concern, and still have the energy to follow through, we are happy to share an excellent summary of the recent Argentinian saga, written exclusively for Mar Asset by Andres Borenstein.

It is a true Argentinian political-economic thriller covering the previous 30 years, fascinating yet disappointing, for Argentina is still losing points in the GDP per capita ranking in the last 100 years.

Andres Borenstein sails with ease through the various political and economic layers of the riveting and complex Argentinian society. Buenos Aires native, economist and trained journalist, River Plate loyal fan, our friend and reference for all things relating to our *hermanos*.

Enjoy!

Argentina under the Kirchners

by Andres Borenstein

In politics, 2+2 does not equal 4. The context in which political developments happen can help to understand why the paths of countries can diverge as Argentina and Brazil have in the last couple of decades above and beyond positive vibes between the leaderships of both countries. In the eighties, people in Brazil used to call it “Efeito Orloff”, as a reference to the advertisement of the famous vodka brand, Orloff. Plan Austral was followed by Plan Cruzado and countries by and large moved in similar pathways. This changed 20 years ago.

In Argentina the economy blew up in 2001. The currency board came to an end after 11 years of the peso being pegged 1 to 1 to the USD. During that decade several important reforms had impacted the economy. Argentina privatized everything, from electricity generation to YPF, the post office, the telecom network, and most roads. The economy was the most open it had ever been, and the deregulation decree signed by Domingo Cavallo in 1991 completely changed the organization of the economy.

The convertibility and its structural reforms helped the country withstand the Tequila and the Asian crisis, but started to flounder with the Russian crisis and, finally, received an Exocet when Brazil depreciated the BRL in January 1999. The last two years were about sustaining a 0-0 in a match where the other team is far superior. When the economy blew up, the FX jumped from 1 to 4 in a matter of months, output shrank by 10.9% in 2002 and over 20% considering the 1998-2002 period. Unemployment surpassed 20% and poverty rates reached 52%, shameful for a country that produces food for 10 times its population. The banking crisis also meant that a good chunk of the middle class had their savings frozen. This is a key factor given that the Argentinean middle class is the equivalent of the US swing voter. The middle class had gone to the streets for the first time since the return of democracy: at first it was an anti-politician agenda “Que se vayan todos”, but as the situation settled, the culprit ended up being the “roaring 90s”.

The political party system was also a victim of the crisis. Over Christmas 2001, Argentina had 5 presidents in a week. The heedlessness law resulted in Congress electing Peronist governor Duhalde as president, who had lost the presidential bid in 1999 and decided to place all his effort on securing the failure of his rivals. Duhalde and his Peronist machinery in the Province of Buenos Aires are said to be the organizers of the lootings in the last days of the De La Rúa government.

Eventually, Duhalde stabilized the economy. Currency devaluation did its job to dilute public spending. Companies renegotiated their dollar debts and also received immense help from the government with the “pesification of debts in the domestic market”. Lots of big firms, including exporters, saw their debts shrink as a result of sales in a dramatic way. The financial system needed tons of regulatory forbearance to avoid showing that it was largely insolvent.

However, the killing of two people in a demonstration forced Duhalde to call elections without him being the candidate. He searched for Peronist candidates but more than two senior figures refused, one of them being the former governor of Santa Fe, Carlos Reuteman, remembered as being one of the competitors of Nelson Piquet in the 80s.

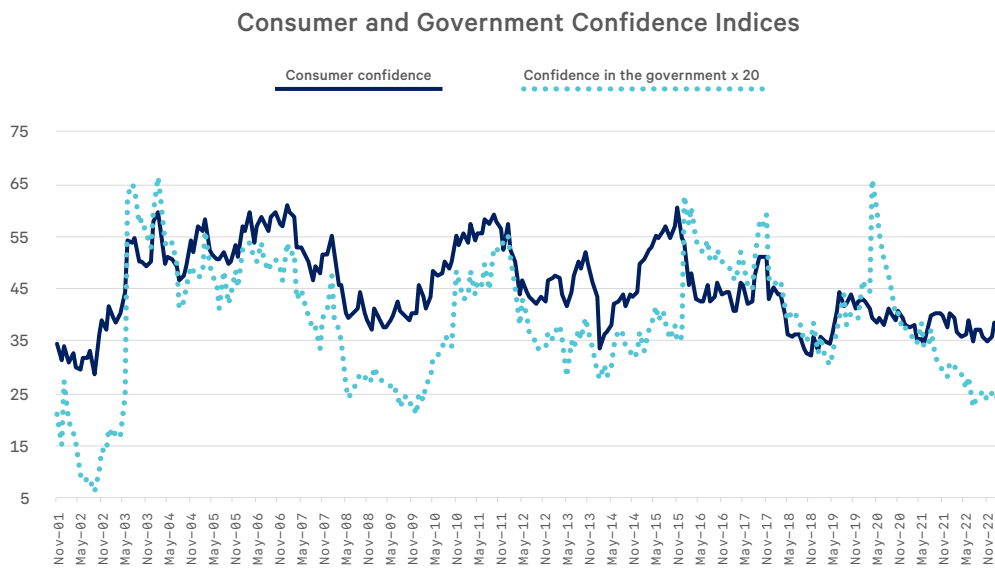
Then came Nestor Kirchner who was governor of a sparsely populated Patagonian Province, not very well known in the major cities. Fragmentation was the name of the game. Menem came first with 27% of the votes and Kirchner second with 23%. Not very far behind came Ricardo López Murphy, a market-friendly fellow with his Chicago-earned PhD. For most people, Argentina’s 50% poverty rate and other social and economic disasters were the results of Menem’s neoliberal policies. So, when the polls showed that everyone would vote for Kirchner in the second round, Menem dropped out. Kirchner became president without getting the legitimacy of a majority vote. It would have been the first ballotage in Argentina’s history, but Kirchner won by walk over.

With Kirchner in power, there was a process of seduction of other forces seeking the legitimacy that votes did not provide, including the construction of a narrative that went in line with the backlash of the “Neoliberal” or Washington Consensus-led reforms. All those became a political liability. The presence of the state as the strong force behind economic recovery,

the construction of a domestic bourgeoisie, and tighter regulations were all primers. Multinational firms and rules-based policies were set aside. There are famous anecdotes of Kirchner purposely keeping international CEOs for hours, only to show domestic stakeholders what were the priorities. In parallel there was a new breed of Patagonian entrepreneurs. Cronies that until 2003 were drivers or bank tellers became the owners of construction companies with multimillion-dollar contracts. “Penguin entrepreneurs” can be called in reference to Patagonian origins. Their money never bought reputation, but with money, they became important in other key businesses, such as in the media, casinos and, to a lesser extent, energy.

Kirchner was a conservative politician. When his province received its share of the privatization of YPF, he quickly put his several hundreds of millions in an off-shore account. This is important in order to understand that Kirchner’s move towards a more state-centric economy was more of an effort to be in line with society’s demands, rather than his ideology. Actually, Nestor Kirchner ran fiscal surpluses every year in his mandate 2003-2007. Nestor understood that fiscal crises were the driving force behind economic crises. Kirchner would receive a one-pager every day containing simple data, such as tax revenues from the previous day, spendings, international reserves, amongst others, to ensure that there was not a crisis in the making.

In 2005 Kirchner betrayed Duhalde. He created another party and Cristina, his wife, competed against Duhalde’s wife for a seat in the House. Kirchner won, marking the transition from Peronism to Kirchnerism. From then on, the Kirchners stopped luring other forces, because They had legitimacy. Economic growth was at its high, as the output gap was nearly 20% in 2003, and inflation was under control. Kirchner could now generate jobs without pressuring the labor market, and enjoyed a surplus of infrastructure (including energy) to grow frictionlessly. The society recognized that the Kirchners were not clean, but they demanded growth and jobs rather than institutions. And the Kirchners delivered. The increase in confidence in the government and, to a lesser extent, in consumer confidence that began in May 2003 (when Nestor became president) were noteworthy.



In political terms, the Kirchners started to think of themselves as unbeatable superheroes. People began referring to Argentina before and after Kirchner. The narrative and the strategic use of social networks became key to attract hundreds of thousands of youngsters and intellectuals. There was a re-discovery of the seventies. They started to use their own media and state propaganda as only Peron had in democratic times.

2007 was a year of key importance, and two relevant factors are worth highlighting: Cristina Kirchner became president in December; and inflation reached 2 digits as the output gap closed. A third important element is that Kirchner began manipulating statistics in order not to show the 2-digit inflation rates. This event sourced the first “default”, as inflation-linked bonds began receiving a coupon that was far below its fair value; which in turn, taints the entire sovereign debt category, both in ARS and in USD.

In parallel, Nestor Kirchner’s prudence was lost. Despite the economy running at its capacity, Cristina decided to push the limits and grow spending in several ways, such as:

- / Incorporating new pensioners without enough contributions, increasing the number of pensioners from 3 to 7 million people.
- / Subsidies to electricity, gas and transport start to increase, as prices remain frozen since 2001.
- / Payroll grows
- / Public infrastructure spending balloons (with a huge dose of corruption, that became evident after the “Cuadernos Affaire”).

Assuming the entire year of 2004 is 100, in terms of real primary spending, the year 2007 was 213 - so spending doubled in a 4-year presidential term. By 2011 the number was 311. By the end of Cristina’s second term, in 2015, the number was 389. Public spending kept on growing, but the economy had stopped at the end of 2011.

Argentina’s consolidated spending (i.e., the federal government, provinces, and municipalities) jumped from 26 to 46% of the GDP. Pension spending rose from 5.8 to more than 11% of the GDP. Economic subsidies did not exist at the beginning of Kirchnerism but represented over 4% of the GDP by 2014/15.

This increase in spending was financed through higher taxation at all three levels of government, the use of stocks such as international reserves (which were completely depleted), the nationalization of pension funds and the capital of utility companies.

A whole generation of Argentineans got used to the fact that a pizza costs more than the monthly electricity bill - something that Macri eventually found out to be an important obstacle, as even some members of his own coalition were against charging the marginal cost to the middle-class clients.

In 2009, a revamp of social programs occurred.

Different versions of universal income had been proposed by non-peronist figures in the aftermath of the 2001 crisis, but the Kirchners always refused to take that remedy. After their defeat in the mid-term elections of 2009, they came up with the child allowance, the first quasi-universal program based on child school attendance. It was Argentina's first proper conditional cash transfer. This was a good program, but as years went by it became one of many. As Argentina has been unable to generate jobs, more and more people live on these programs. While in the first few years social programs would not take more than 0.5/0.7% of GDP, Argentina today spends well over 2% of GDP in the Federal government alone and yet there is 40% of poverty.

Moreover, this weakened the role of traditional actors such as the unions and strengthened the role of "piqueteros", which are the representatives of these informal workers or unemployed and also often the intermediaries. To get into the list, you need to belong to one of these organized groups.

The defeat of 2009 was quite something, but one can claim that the global crisis coupled with a drought were also contributing factors for a weak economy. While this is true, it is important to recap and go back to 2008 - the year of the "rule 125". The Kirchners wanted more money and looking at soybean and corn prices, they decided to come up with a sliding scheme for taxing exports that meant marginal rates of up to 90% when soybean prices surpass 600 dollars a MT. This revamped an old Peronist fight against farmers. Peronists have a traditional way of thinking of a fixed factor when it comes to agribusiness. Their books completely jumped the green revolution which meant that Argentina increased its crop from 40 to over 100 million tons in a generation. They completely misunderstood the concept of farmers, which was no longer an oligarch with large areas, but rather talented young engineers that rented land to maximize production.

The increase in export duties generated a tax revolt, that was eventually supported by the urban middle classes. Cristina Kirchner doubled the bet several times during this revolt and on one of those occasions decided to

send to Congress the increase in taxation. That went through the lower house and when it reached Senate the conflict had escalated, leading to some Peronist senators in key agriculture provinces voting against or abstaining. So, even when the Kirchners controlled both houses of Congress, the vote was tight. It went all the way until 6 AM in the morning and it was a draw: 36 to 36 - giving the vice president the deciding vote: and he voted against his own government. For many people the “agri-crisis” is the beginning of “la grieta”, the great divide. From then on one can find millions of fanatic Kirchnerists and millions of fanatic anti-Ks. Loads of stories of long-standing friendships were broken, and families were dissembled due to this political polarization.

The agri-crisis was probably the only one time that the Kirchners could not exercise control of the legislative branch. For most of the Kirchner era, Congress was an easy ride. In Argentina provincial parties tend to be in line with the government and when there are independent forces, the Kirchners always managed to buy them either with cash or approving public works for the province. In a nutshell, Congress was almost never a relevant political factor.

The Judiciary system was a different story. The Kirchners started with the right foot using some of the vacancies in the Supreme Court to appoint people with good reputation. That bought them a reputation that they eventually did not deserve. Since they controlled the Senate they had the liberty to appoint judges and they certainly made good use of that advantage. They created a group called “Justicia Legitima”, made of judges and prosecutors aligned with the Kirchners making sure that many of the corruption cases could not go through, amongst other elements. Some elements of independence in the Judiciary remained, but it is fair to say that the tradition of the Judiciary is that they change sides as soon as power changes hands or there is an expectation in that direction.

The relationship with corporations changed over the years. The pesification of debts was an important help. Eventually, Kirchner allowed Clarin, the closest to Globo you can find in Argentina, to merge two cable networks giving them wide monopolistic powers. All flowed until Kirchner felt that in the agri crisis Clarin sided with the farmers and the urban middle class.

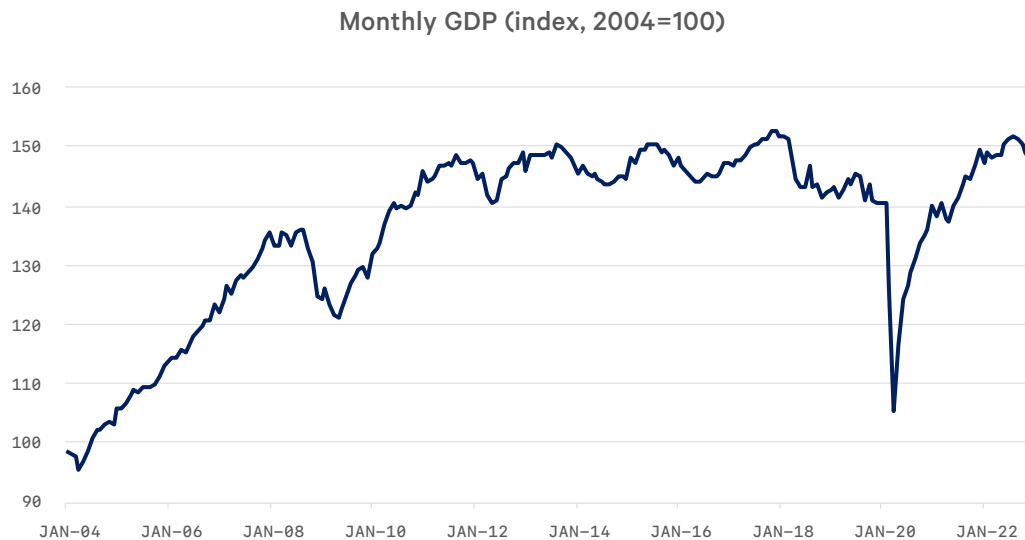
Going back to war with corporations, there were two landmarks. Firstly, the media law (eventually repealed by Macri), which was meant to destroy Clarin. Secondly, in 2008 Argentina nationalized the private pension funds. So the government not only started to receive the money previously going to the funds, but also inherited the stock. In that stock there was equity in all listed firms in the local exchange. They were stakes of 10 to 25% of listed firms. The Court interpreted the law in a particular way because pension funds could not use their voting power to impose board members, but the state-appointed board members in all these companies.

So suddenly, there were some board members that, instead of trying to maximize value, would rather reduce value of the firm to maximize public interest, as it was a publicly owned firm.

So, businessmen who enjoyed high margins (this is a classic watermark of populism) and enjoyed debt pesification started getting worried. The fact that media was mostly under control, that speaking out may mean losing contracts or receiving tax inspections, meant that businessmen cowardly said very little.

The flagship ideas of Kirchnerism were the following

- / Cheap electricity and gas for everyone
- / Appreciated exchange rate as a way to shorten the gap between comfort (i.e. travel, smart phones) and people
- / The state regulates economic activity
- / Rents for the friends (protection for industrialists, public works for construction companies, import authorizations, government procurement). This keeps the local business community at bay. Many local businessmen would not be able to sell their firms for a reasonable price under the Kirchners, but would make a huge dividend yield. Cash over long-term value.
- / The society does not have appetite for change, as they have a fake welfare.



Over the years this fake welfare started to show cracks. Blackouts, fewer buses, import authorizations (lack thereof) mean that the economy is under supplied, etc.

The problem arises when you come with a rational plan trying to change. Only some people perceive the need for change while some believe in magic realism, because they feel as a normal situation that electricity is cheaper than pizza. If there are blackouts, it is only because companies are evil.

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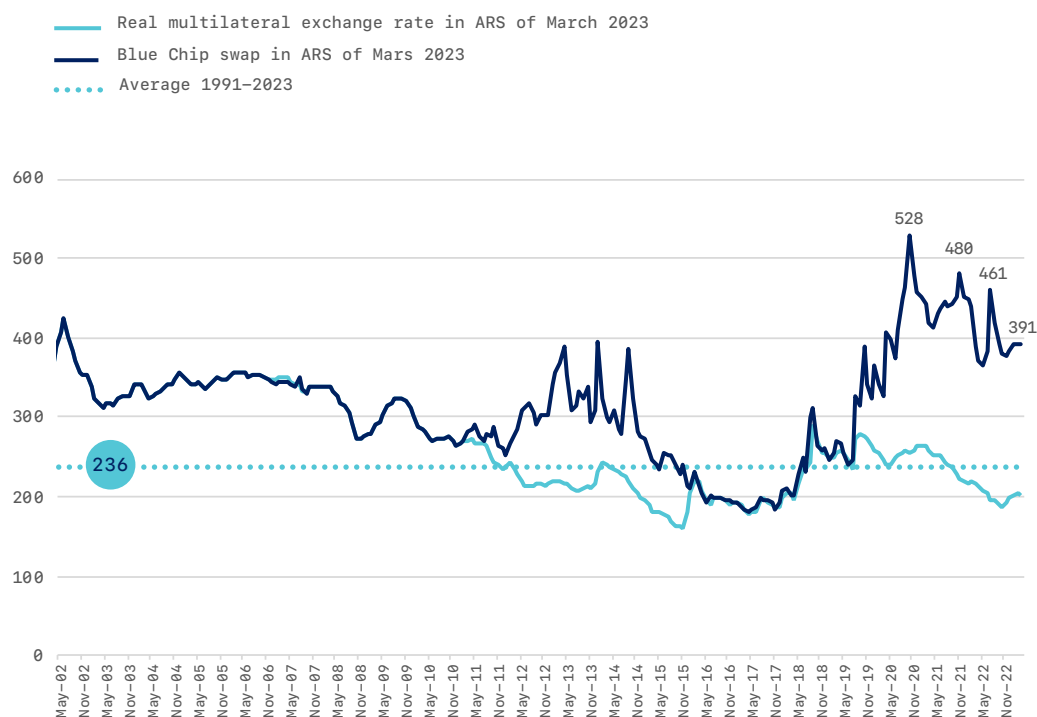
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The FX populism

The exchange rate which was super competitive at the beginning of Nestor Kirchner, became in line with the equilibrium levels when Cristina took over and then continued to appreciate and reached 2015 being one of the most appreciated values in history.

As inflation eroded competitiveness and the dollar became cheap, there was an obvious shortage of dollars that either needed the supply from the Central Bank or a depreciation. The only one that Kirchnerism allowed was at the height of the global crisis in 2009, but then it preferred to sell dollars from the Central Bank.

Parallel exchange rate vs official (in real effective terms) in Argentina



At that time Cristina was president, but Nestor was still calling the shots. His death, in 2010, ended with the last pieces of conservatism. Cristina decided to “go for everything”. When the economy recovered quickly in 2010 and she used her widow character to regain popularity and they ended in a landslide in the 2011 election.

After the 2011 election in which Cristina beat Hermes Biner (socialist) by a huge margin. The election was 54.1% versus 16.8%, over 3x the size. This would have allowed paying the political cost of a devaluation. Instead, Cristina imposed FX controls. These controls have decreasing marginal returns, which means that the Central Bank had to tighten the screws several times. By the time Cristina handed over the government the real

multilateral exchange index showed that the ARS was stronger than at any time since democracy returned in 1983, including the currency board.

So the economy was trapped with low productivity, closed to foreign competition, appreciated exchange rate, completely distorted relative prices. Foreign direct investment is one signal. In the nineties Argentina was the poster child. During the Kirchners not just Brazil and Mexico received more money (they are far bigger), but also Chile, Peru and Colombia received far more dollars.

Getting out of populism is tough

One can discuss why Macri government was not successful. For sure, it was a combination of a huge negative legacy from Cristina, his own government mistakes and the necessary dose of bad luck with the Fed starting to tighten in 2018 coupled with a severe drought, that kept the dollar inflow ultra-dry.

Above and beyond the mistakes, breaking with the culture of a super state that takes care of everyone's pensions, the electricity bill, the subsidy for transportation, the social handouts, protection for uncompetitive firms was difficult in the first place.

Macri once said that he faced an asymptomatic crisis and therefore he faced no demand for change in society and this meant that even his constituency could not understand why electricity bills had to be multiplied by 5.

This is perhaps the biggest challenge for whoever wins the next election.

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