

INVESTOR'S BUSINESS DAILY®

Argentina Bolts Towards Free Market Reforms

December 17, 2015

Revolution: One week into office, Argentina's new president has slashed taxes, ripped out capital controls and restored the peso to its natural level. It takes guts, but this blaze of reforms has worked wherever it's been tried.

The markets certainly think it will, with some stocks rising as much as 5% and the overall market not panicking in the wake of President Mauricio Macri's announcement that capital controls are now a thing of the past. The move triggered a wrenching 27% devaluation of Argentine currency, causing it to fall from 9.8 pesos to the U.S. dollar to 13.9.

It will likely force prices to rise by half in the short term and could trigger protests from the country's powerful Peronist unions. But it's the speed with which the move took place that puts time on Macri's side and a sign that the distasteful maneuver will work.

After all, Macri has been in office since only Dec. 10, and his biggest likely political opponents, such as the Peronist socialist labor unions, are still licking their wounds since his landslide victory. Economists such as Johns Hopkins University's Steve Hanke have pointed out in the past that free-market reforms tend to have the best results when they are executed quickly, with conviction. That's precisely the path Macri is taking in his lightning-bolt moves. It's an interesting thing from a man whose family business has included race cars.

What's more, unlike devaluations past, Macri prepared the country for this one. The need for the devaluation is the ugly result of the previous socialist government's effort to control the economy and create a falsely inflated currency based on phony statistics so bad that even the International Monetary Fund complained.

Three days ago, Macri set the country up for recovery by cutting its punitive personal and export taxes so that there would be incentive to work and save.

Two days ago, he lifted capital controls so that export trade, Argentina's great competitive advantage, could take off once again. Argentina's farmers and ranchers have said that they could rake in \$400 million a day in export revenues based on high inventories of grains and other agricultural products if those punitive taxes were scrapped. Barron's reported that they pulled in only \$72 million in seven days last week, so the capital inflows should be instant.

A few days before that, Macri moved to protect savers somewhat by firing the central bank chief and having the new one hike interest rates from 7% to 38% to alleviate the shock of devaluation. He also sold \$3 billion in Chinese yuan and other not-so-useful foreign currencies touted by the anti-American crowd and bought U.S. dollars to help buttress the country's foreign exchange cushion and protect savers some more.

In addition, he threw out two leftist Supreme Court judges and replaced them with rule-of-law advocates — an important move given that U.S. Federal Judge Thomas Griesa in a bondholders' lawsuit laid down the law to Argentina, telling it that it must pay its bills and cannot default (as it notoriously does) without consequences. Rule of law will go far to help the country restore its past prosperity — and more importantly, it will lay the groundwork for the next step: restoring Argentina's presence in world capital markets, which it's been out of since its \$100 billion sovereign default in 2001.

These preparatory reforms — some admittedly painful — will go a long way toward hastening economic recovery and — with Macri's expected next step, fiscal reform — will keep the downturn short. In a country with 25% inflation, 29% poverty and 0.4% growth for 2015, the IMF is forecasting a single tough year in 2016 to be followed by a spectacular 7% growth in 2017.

Already there are signs that it's working, and not just in the markets but in hard-core, tangible foreign investment. In just days, Spanish oil giant YPF announced a \$500 million expansion, while international banks are prepared to lend \$25 billion to finance more reforms.

With a record like that, it's a slam-dunk that the failure and impoverishment of Peronist socialism will be history and the Argentina that a century ago was a global symbol of wealth will re-emerge. It's happened every time it's been tried.