



SOCIETY OF ACTUARIES

Article from:

# International Section News

October 2001 – Issue No. 26

# Argentina—Is a turnaround around the corner?

by Jorge Noronha

## Economic Overview

**A**rgentina has been appearing very frequently in the headlines these days. It is not due to a new revival of the tango or to the high-hopes placed on its national team—a favorite to win next year's World Cup. Argentina has been relying heavily on the IMF, having borrowed nearly \$22 billion since December. It is hoped that this money will restore confidence in their country's crippled economy and in their ability to service the \$127 billion public debt. Argentina has been languishing in a three-year recession and the country risk is now the second highest in the world (Nigeria tops the list). Argentina is the 2nd largest economy in Latin America and retains an important part of emerging countries' debt.

As part of the IMF agreements, the government has passed a "zero deficit" law prohibiting the government from spending more than it raises in taxes. This would be mainly be derived from cuts of up to 13% in state pensions and salaries. The government would also have to reach fiscal balance in 2003.

The cuts in spending have left the provinces with little room to breed. To cover its expenses, for example the province of Buenos Aires had to issue a special type of bond, known as "patacones." Utility companies, supermarkets, the tax authorities and even McDonald's, which is offering a special "Patacombo" menu in return for a \$5 bond, would be willing to accept the bonds.

The Argentine peso is currently pegged to the dollar. Under the currency board, Argentina's central bank allows interest rates to float according to the mood of investors. Since Brazil devalued its currency in January of 1999 by over 50%, Argentina has become an extremely expensive country in which to do business. While a devaluation may seem like the easy solution, such a move would be costly (around 70% of bank deposits and private-sector debt is denominated in foreign currency).

In light of the severe fiscal cuts, Argentina is expected to contract again in 2001 before recovering slowly in 2002 along with most of the world economies.

## Privatized Social Security Market

With the thrust of the privatization of social security schemes in Latin America, Argentina created its own private pensions schemes in late 1994. They require workers to contribute 13% of their salaries to an individual account privately managed by an AFJP (Private administrator of Pension Funds). The funds under management have been growing steadily and currently total U.S. \$17 billion. However,



given that labor laws are too restrictive and that employers want to avoid paying social security taxes, 40% of all workers do not have legitimate employment contracts and thus do not make the required contributions. The government is trying to implement a variety of reforms in the National Social Security

Commission (ANSES) to reduce its expenditures and increase the speed in which pensions are processed. In some cases can take years. The Government also passed a number of decrees to decrease the level of government funding for retirement benefits and to correct some of the flaws in the current system. These changes are a step in the right direction, but the government has refused to accept the privatization of ANSES, which many agree is what is needed if the system is to improve dramatically.

## Banking Sector

The number of banks today is nearly half what it used to be five years ago. It is a tightly concentrated market with nine banks holding 70% of all deposits. However, the banking industry is highly inefficient, service is poor and the branches are overstaffed. On top of this, the level of assets per branch is very low, making service fees a natural source of revenues. While by law, all employ-

ers are legally bound to deposit the paychecks into a bank account, fewer than 30% of Argentines possess one. This is making competition stiff and driving returns on some banks down significantly. Banks have tried to supplement their income by becoming distributors of financial services, for example:

- Galicia bank has a joint venture with ITT Hartford
- HSBC owns an insurance bank, pension administrator and health company all of which distribute through the bank
- Banco Rio formed its own insurance company to sell credit life and supplementary life coverages

## Health Care Reforms

The deregulation of the health market was due to start on 1 January of 2001. This would allow private health companies "Prepagas" to compete against the existing providers "Obras Sociales" by collecting the mandatory contributions and offering health coverage. However, a variety of rules have remained undefined which has prompted all of the Prepagas to withdraw from participating in the deregulated market. Topping the list of concerns of the Prepagas are the inability to decline coverage to any insured, and the obligation to provide a minimum level of services for a fixed premium.

## Individual Life Market

### Overview

The early '90s brought a number of foreign players into the Argentinean insurance market. They invested highly in creating agency forces, but with only 1 in 10 agents surviving to the 4<sup>th</sup> year, it became an expensive

proposition. In light of this, a number of companies started turning their agency forces into independent sales agents (NYL and Principal are just two examples). At the end of 2000, the individual life production stood at US\$460 million having grown from negligible amounts in early 1994.

### New Investment Regulations

Starting this August, life insurers will be permitted to invest up to 50% of the reserves of all new policies in foreign investments (previously the limit was the lesser of 10% of reserves or 30% of the minimum capital). This new regulation allows insurers a wider

most of the '80s are considered to be the lost decade when the economy hardly grew, followed by a period of aggressive growth in the '90s. The insurance market grew significantly between 1991 and 1994 (average of 15%), then retroceding in 1995 and 1996, increasing again in 1997 and 1998 and growing slightly in 1999 and 2000 when the economy took a downturn.

The light at the end of tunnel is bright. Many expect that the individual life and provisional market will grow at an average rate of 20% for the next five years. The superintendency of insurance has become more aggressive in shutting down insurance companies that are insol-

*"Argentina has gone through period of uncertainty in the past. In fact, most of the 80's are considered to be the lost decade when the economy hardly grew, followed by a period of aggressive growth in the 90's."*

breadth of instruments in which to invest and minimizes the risk in the portfolios. It is expected that this new regulation will spur the growth of unit-linked products, which up to now have been mainly distributed through a few providers. Currently the individual life market is highly concentrated with Zurich-Eagle Star possessing 30% of the life market and the top seven insurers selling 75% of the business.

### What lies ahead ?

Argentina has gone through periods of uncertainty in the past. In fact

vent (having closed nearly 20 companies in the past year alone). The government has also been left with no choice but to continue to push ahead with its reforms on the health-care and provisional sectors, as part of the IMF agreements.

*Jorge Noronha is senior consultant with Inmark-NMG in Argentina and a member of the International Section Council. He may be reached at jorge.noronha@inmark-nmg.com.*