

Better off Without Them?

By Alan Cibils | October 20, 2004

There is a popular saying in Argentina: *más vale estar solo que mal acompañado* (better to be alone than in bad company). Increasingly Argentines are wondering whether it isn't time to go it alone and leave the International Financial Institutions (IFIs, the IMF, the World Bank, and the Inter-American Development Bank) behind.

During his August 31st, 2004 ten-hour, self-invited visit to Argentina, IMF Managing Director Rodrigo Rato told President Néstor Kirchner: "At the IMF we have a problem called Argentina." Kirchner promptly replied: "I have a problem called 15 million poor people," a clear reference to what Kirchner considers the outcome of decades of mistaken IMF policy prescriptions in Argentina.¹

This frigid exchange is an indicator that the relationship between Argentina and the IMF is not going smoothly. In fact, the three-year agreement with the Fund, signed in September of 2003,² is in limbo. In what has become a regular event, the IMF delayed approval of the third quarterly review of the agreement due in July, alleging that Argentina had not complied with certain structural reforms.

In previous reviews, Argentina responded to IMF delays by threatening to default on its \$15 billion debt to the institution.³ This time, however, Argentine officials tried a novel strategy: President Kirchner and Economy Minister Roberto Lavagna decided to unilaterally suspend the agreement until January, 2005 and pay the IMF on schedule the \$1.5 billion due between August and January. While this approach temporarily gets the IMF off Argentina's back, it is by no means a sustainable arrangement. As Table 1 shows, without the refinancing of capital payments provided by the agreement, Argentina must face impossible debt service payments in the coming years, reaching 8.2% of GDP in 2005.⁴ This would be roughly equivalent to 35% of total government spending in 2005, an unthinkable amount given

the huge need for government spending required to undo 10 years of IMF-mandated austerity and the magnitude of the social crisis. According to the Argentine government, unemployment is at 19.1%, underemployment is at 15%, 44% of the population is below the poverty line and almost 20% of the population is indigent.⁵

How did Argentina get so deep in the debt cycle? Is there a way out?

TABLE 1. DEBT SERVICE SCHEDULE 2005-2010

(IN MILLIONS OF DOLLARS)

Type of Debt	2005	2006	2007	2008	2009	2010
1. IFI total	6,365	6,020	4,732	2,155	1,606	1,364
IFI as % GDP	4.0%	3.5%	2.6%	1.1%	0.8%	0.6%
Capital	5,545	5,364	4,261	1,821	1,344	1,157
Interest	820	656	471	334	262	207
2. Performing total	5,731	5,267	4,626	4,164	6,504	4,669
Performing as %GDP	3.6%	3.1%	2.5%	2.1%	3.2%	2.2%
Capital	4,802	4,399	3,812	3,431	5,884	4,190
Interest	929	868	814	733	620	479
3. Restructured total	1,137	1,173	1,210	1,249	1,290	1,575
Restructured as % GDP	0.7%	0.7%	0.7%	0.6%	0.6%	0.7%
Capital	0	0	0	0	0	0
Interest	1,137	1,173	1,210	1,249	1,290	1,575
TOTAL Debt Service	13,233	12,460	10,568	7,568	9,400	7,608
Total as % GDP	8.2%	7.2%	5.8%	3.9%	4.6%	3.5%

Source: Calculations based on Schvarzer and Finkelstein (2004).
Assumptions: GDP is \$161 billion in 2005; growth rate is 4% in 2005 and 3% in each consecutive year.



Much is at stake for both Argentina and the IMF in the current negotiations. Central issues are Argentina's defaulted debt renegotiation process, the country's continued debt payments to the IFIs, and its ability to design and implement economic policies that run contrary to IMF prescriptions but would reduce its appalling levels of hunger, poverty and unemployment.

The Unattainable Goal of a Manageable Debt

Since the onset of the social and economic crisis three years ago, national and international attention focused on Argentina's gargantuan public debt. In December 2001, at the height of the crisis that sealed the fate of Argentina's decade-long experiment with rampant neoliberalism, president-for-a-week Adolfo Rodríguez Saá defaulted on roughly \$80 billion of Argentina's debt with private creditors (predominantly individual and institutional bondholders). However, Rodríguez Saá did not default on Argentina's \$30 billion debt to the IFIs.

Argentina's chaotic devaluation in early 2002 resulted in the accumulation of an extra \$35 billion in public debt, mostly to bail out banks and private businesses. This "new" debt, added to IFI and defaulted debt brings total public debt to approximately \$180 billion, roughly 130% of GDP.⁶

Argentina's emergence from default requires negotiating a swap of the old defaulted bonds for new ones. To begin this process, in September 2003 Argentina issued a set of conditions to creditors under which it was willing to restructure its debt.⁷ These included a 75% capital reduction or "haircut," considerably lower interest rates, longer maturities, and no recognition of interest due since the default. Creditors were outspokenly opposed to these restructuring conditions and demanded a higher offer. One of the more outspoken groups, the Global Committee of Argentine Bondholders (GCAB), teamed up with the IMF to pressure Argentina for a better deal for private creditors.

IMF and creditor pressure resulted in a new offer on June 1st, 2004. Known as the "Buenos Aires proposal,"⁸ the new offer doubled interest rates and reduced the

haircut from 75% to between 52 and 46%, depending on how many bondholders accept the restructuring offer.⁹

Since most of the new bonds (to be swapped for the ones in default) will be issued in New York, the Argentine proposal needed the approval of the U.S. Securities and Exchange Commission (SEC). The critical green light from the SEC came on September 29th and the bond swap is scheduled to be launched by mid November. Creditor groups, especially the GCAB, are still not happy and the IMF continues to pressure Argentina to up its offer.¹⁰

The alarming news is that even if a majority of defaulted creditors take the Argentine government's offer,¹¹ total debt would only shrink by approximately \$50 billion dollars, to about \$130 billion—a whopping 90% of GDP.¹² Most economists agree that this is still a dangerously unsustainable debt level. For example, The European Union agreed to a maximum 60% debt-to-GDP ratio in the Maastricht Treaty. Former IMF Chief Economist Kenneth Rogoff concluded in a recent paper that a sustainable debt level for a country like Argentina would be about 30% of GDP.¹³

Furthermore, as Table 1 shows, there are extremely heavy debt service payments due in the next 5 years. If Argentina does not manage to reach some sort of refinancing arrangement with the IMF, most of the country's \$15 billion debt with the Fund will have to be paid off in 2005-2007.

Even in the best case scenario of a successful debt restructuring along the Buenos Aires proposal guidelines, Argentina's still-huge public debt continues to leave the country on the verge of another major crisis.

The outcome of Argentina's debt saga depends largely on how the current standoff with the IMF is resolved and on the country's substantial debt to the IFIs.¹⁴ Argentina's debt situation cannot be resolved in any meaningful way if it continues under the tutelage of the IMF—forced to continue to implement failed policy prescriptions on the one hand, and to bleed out its coffers through IFI debt payments on the other.

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problem called Argentina."

The IFIs: Better Off Without Them?

There are at least six good reasons for Argentina to consider leaving the IFIs behind and forge its own future. First, Argentina's explosive debt accumulation and resulting crisis were due, in large part, to the implementation of IFI promoted economic policies during the 1990s. Just one of these policies—the privatization of the social security system foisted upon Argentina by the World Bank (WB) and required by the IMF—is one of the major culprits of Argentina's fiscal deficits since 1994 and contributed heavily to the public debt explosion.¹⁵ The WB is now backtracking from its earlier dogmatic stance on the superiority of market solutions for workers' retirement, acknowledging that a strong state-sponsored program should be the backbone of the retirement system. However, in Argentina the damage is already done.

Second, the IMF's blunders in Argentina in the 1990s are also well known and much has been written on them.¹⁶ However, the IMF refuses to admit its mistakes. The so-called Independent Evaluation Office, in reality a branch of the IMF, recently completed a study on the IMF's performance in Argentina during the 1990s. The study lays the blame for the crisis squarely on Argentine government officials, parroting the usual IMF line about Argentina's fiscal profligacy and incomplete structural reforms.¹⁷ The only mistakes the IMF admits to are not having supervised Argentina closely enough and not having paid enough attention to warnings sounded prior to 2001 that the fixed-exchange rate regime was in trouble. Indeed, not only did the IMF ignore clear warnings, but they tripled their exposure to Argentina in the months preceding the December 2001 crisis, taking total loans to Argentina from \$5 billion to \$15 billion. In sum, the IMF was unprepared for the crisis, prescribed mistaken economic policies—such as government spending cuts in the middle of a deep recession—and poured money into Argentina to prop up an unviable system.

Third, the IMF's management of the Argentine crisis (since December 2001) has been plagued with errors in diagnosis, macroeconomic projections, and policy prescriptions. In an unprecedented document published in

early July, the Argentine government described in detail IMF mistakes.¹⁸ For example, six months into the economic recovery following the crisis, the IMF continued to predict that hyperinflation and a major banking system collapse were imminent. Needless to say, neither happened. The government's paper highlights the extent of IMF cluelessness and inability to deal with the crisis. The document also details IMF meddling in national affairs far outside its official mandate, such as demanding modifications to the bankruptcy code and the repeal of a law that allowed for the prosecution of white-collar crime.

Fourth, the IMF continues to act in a highly contradictory way. On one hand, it acts as a lobbyist for defaulted private creditors, demanding that Argentina raise its debt-restructuring offer and insisting that the government pay off its debt to the IFIs.¹⁹ On the other hand, the IMF has also insisted that Argentina eliminate export and

financial transaction taxes, which together account for one third of the government's revenue, because it claims these taxes "distort" the price structure. So as the IMF pressures for significantly higher payments to creditors, it also demands measures that would deeply cut government revenue. Meanwhile, Argentina's millions of poor and unemployed don't even enter into the IMF's equation.

Fifth, since the December 2001 crisis, Argentina has made net payments to the IFIs to the tune of \$8.2 billion.²⁰ During

the worst economic crisis of its history, rather than receiving fresh loans from the IFIs and applying scarce resources to alleviate poverty, generate employment and kick-start the economy, Argentina was instead sending its revenues to the IFIs.

Finally, the IFIs have not only prescribed mistaken and harmful policies and made bad loans, but they claim "preferred creditor" status, expecting to cash in ahead of all other creditors. In other words, contrary to the laws of the market they so vehemently promote, they are accountable to no one nor will they pay for their mistakes.

The huge social and economic costs of IFI mistakes have Argentines asking: why should IFIs not pay for their mistakes, much like private creditors pay for bad invest-

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ments? And how does Argentina benefit by maintaining its links to these institutions?

Which Way Now?

Come January 2005, Argentina will have to decide what its relationship to the IMF will be. Will the agreement signed in 2003 be restored? Assuming a successful defaulted debt restructuring, Argentina's debt sustainability will still not be guaranteed, especially if it must pay off the IFIs. What are the options?

The most desirable—and least likely—option is debt forgiveness along the lines proposed by the Jubilee Network.²¹

However, Argentina does not fit the IMF's "heavily indebted poor country" definition that is needed to qualify for debt cancellation. Furthermore, it appears that the IMF wants to make an exemplary case of Argentina for having defaulted on its debt, making debt forgiveness even less probable.

The least desirable option—and the most likely—is a restoration of the currently suspended agreement. Despite the Argentine government's combative rhetoric, when push comes to shove Argentine officials have caved to the IFIs in the past and are likely to continue to do so. The only benefit of a renewed agreement with the IMF would be a roll-over of capital payments. The drawbacks would be adoption of IMF conditionality and mistaken policy prescriptions with huge human costs. There would be a political cost as well. Given the government's detailed and public exposure of IMF blunders and their enormous social consequences, how will it justify a renewed relationship with the Fund? If this option is chosen by Argentine officials, they should at least demand that IFIs submit to the accountability framework recently proposed by the Center for Economic and Policy Research.²² Such a framework would make IFI economists accountable for their economic projections and policy prescription outcomes.

A third option is to default to the IFIs and force a debt restructuring. The advantages would be considerable: freeing up resources for development and regaining sovereignty over policy design and implementation. The price to pay is not as clear. The cost mentioned most often is the interruption of access to international credit markets, but Argentina has not had access to these mar-

kets since 2001 and has still managed to emerge from the crisis. Furthermore, Argentina has large primary fiscal and trade surpluses, and therefore the country has been mostly self-financing. Another cost often mentioned is the interruption of foreign investment. This is unlikely, since foreign investors care more about profit opportunities and a predictable investment climate than about IMF agreements. The political

costs are more of an unknown. A successful break with the IFIs is an example that the G-7 and the IFIs themselves would like to avoid. It is not clear to what extent they would go to do so.

The road ahead for Argentina is bumpy. However, increasingly it looks like Argentina would be better off traveling without the IFIs. One thing is clear, as Rato said, the IMF has "a problem called Argentina." Being the stone in the shoe of the IMF gives Argentina considerable leverage. It should use that leverage to finally break dependence on bad IFI policies.

Why should IFIs
not pay for their mistakes,
much like private creditors pay
for bad investments?

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ENDNOTES

- ¹ When the IMF's so-called Independent Evaluation Office issued a report on the Fund's performance in Argentina during the 1990s, Kirchner stated that the IMF's mistakes "cost us 15 million poor people" ("Para Kirchner los errores del FMI costaron 15 millones de pobres" by Mariano Obarrio, *La Nación*, July 31, 2004).
- ² For an analysis of that agreement, see "Argentina's IMF Agreement: The Dawn of a New Era?" by Alan Cibils, (Silver City, NM & Washington, DC: Foreign Policy In Focus, October 10, 2003) (<http://www.fpif.org/commentary/2003/0310argdefault.html>).
- ³ For further details, see "Argentina and the IMF: Down to the Wire—Again" by Alan Cibils (<http://www.americaspolicy.org/reports/2004/0404argintinedebt.html>).
- ⁴ Data in Table 1 is based on "Renegociación de la deuda: un panorama confuso de montos, quitas, pagos y sustentabilidad futura" by Jorge Schvarzer and Hernán Finkelstein, *Centro de Estudios de la Situación y Perspectivas de la Argentina*, Notas de Coyuntura N°16, August 2004 (<http://www.econ.uba.ar/www/institutos/economia/CESPA/archivos/NC16CESPA.zip>).
- ⁵ See *Instituto Nacional de Estadística y Censo* (INDEC, www.indec.gov.ar), Argentina's official statistics agency.
- ⁶ Argentina's current public debt composition is as follows:
Approximately \$32 billion of IFI debt,
Approximately \$48 billion of "performing" debt, which includes \$35 billion of new debt plus other private debt not included in the default, and
Approximately \$100 billion currently in default and in the process of being renegotiated.
- ⁷ The restructuring conditions and other official debt-related information and data can be found at: <http://www.argintinedebtinfo.gov.ar/>.
- ⁸ The specifics of this proposal haven't been made officially available yet. Information publicly available comes from a government press conference on the issue and the Argentine government's presentation to the U.S. SEC, available at: http://www.argintinedebtinfo.gov.ar/documentos/preliminary_base_prospectus.pdf.
- ⁹ The haircut is smaller if more than 70% of bondholders accept the new offer. For detailed information on the new offer, see Jorge Schvarzer and Hernán Finkelstein (2004).
- ¹⁰ See, for example, IMF Managing Director Rodrigo Rato's remarks at the Council on Foreign Relations on September 20th, 2004, as reported in "Fuerte reclamo del jefe del FMI a la Argentina" by Jorge Rosales, *La Nación*, 09/21/04. (Buenos Aires's two other major dailies, *Clarín* and *Página/12* also reported on Rato's remarks).
- ¹¹ In a recent article, the *Financial Times* predicted that the swap would be successful simply because defaulted creditors are sick and tired of dealing with the issue and will probably accept the Argentine government's latest offer ("Argentina closes in on sweet debt relief deal" by Adam Thomson, *Financial Times*, September 20th, 2004).
- ¹² When Argentina defaulted on its debt in December 2001, total public debt was 50% of GDP.
- ¹³ Kenneth Rogoff, Carmen Reinhart and Miguel Savastano: "Debt Intolerance," *National Bureau of Economics Research Working Paper 9908*, August 2003 (<http://www.nber.org/papers/w9908>).
- ¹⁴ Assuming a successful defaulted debt refinancing, 25% of total Argentine public debt will be with the IFIs.
- ¹⁵ See "The Role of Social Security Privatization in Argentina's Economic Crisis" by Dean Baker and Mark Weisbrot, *Center for Economic and Policy Research*, April 16, 2002 (http://www.cepr.net/argentina_and_ss_privatization.htm).
- ¹⁶ For example, "Argentina Since Default: The IMF and the Depression" by Alan Cibils, Mark Weisbrot, and Debayani Kar, *Center for Economic and Policy Research*, Briefing Paper, September 3, 2002 (http://www.cepr.net/argentina_since_default.htm).
- ¹⁷ The IEO study can be found at: <http://www.imf.org/External/NP/ieo/2004/arg/eng/index.htm>. For recent remarks by IMF officials repeating similar arguments, see Anne Krueger's March 23, 2004 lecture at NYU (<http://www.imf.org/external/np/speeches/2004/032304a.htm>), Anoop Singh's March 27, 2004 speech at the Inter-American Development Bank's annual meeting in Lima, Perú (<http://www.imf.org/external/np/speeches/2004/032704.htm>), and Anne Krueger's March 31, 2004 presentation at the American Enterprise Institute in Washington, DC (<http://www.imf.org/external/np/speeches/2004/033104.htm>).
- ¹⁸ The document was signed by President Kirchner, his Chief of Staff, and by Minister Lavagna and his entire cabinet. It is titled "Análisis N° II: Argentina, el FMI y la Crisis de la Deuda" and can be found at: http://www.mecon.gov.ar/analisis_economico/nro2/2_fmi_crisis_deuda.pdf.
- ¹⁹ This is clearly stated in the official document on the IMF mentioned in the previous paragraph.
- ²⁰ According to an explanatory text accompanying the 2005 Federal Budget bill, Argentina has paid the IFIs a net \$1.2 billion in the first six months of 2004. According to Minister Lavagna's presentation at the joint WB-IMF meetings in March 2004, Argentina made net payments of \$7 billion in 2002-2003.
- ²¹ For more information, see <http://www.jubileeusa.org/>.
- ²² For more information see "Applying Economics to Economists: Good Governance at the International Financial Institutions" by Mark Weisbrot and Dean Baker, *CEPR*, July 2004 (http://www.cepr.net/publications/ifi_accountability.htm).

FURTHER INFORMATION:

“Argentina and the IMF: Down to the Wire—Again” by Alan Cibils

(<http://www.americaspolicy.org/reports/2004/0404argentinedebt.html>).

“Argentina’s IMF Agreement: The Dawn of a New Era?” by Alan Cibils, (Silver City, NM & Washington, DC:

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“Renegociación de la deuda: un panorama confuso de montos, quitas, pagos y sustentabilidad futura” by Jorge Schvarzer and Hernán Finkelstein, *Centro de Estudios de la Situación y Perspectivas de la Argentina*, Notas de Coyuntura N°16, August 2004

(<http://www.econ.uba.ar/www/institutos/economia/CESPA/archivos/NC16CESPA.zip>).

Instituto Nacional de Estadística y Censo (INDEC, <http://www.indec.gov.ar/>).

Information on Argentina’s debt:

<http://www.argentinedebtinfo.gov.ar/>

“Debt Intolerance,” Kenneth Rogoff, Carmen Reinhardt and Miguel Savastano, *National Bureau of Economics Research Working Paper 9908*, August 2003

(<http://www.nber.org/papers/w9908>).

“The Role of Social Security Privatization in Argentina’s Economic Crisis” by Dean Baker and Mark Weisbrot, *Center for Economic and Policy Research*, April 16,

2002 (http://www.cepr.net/argentina_and_ss_privatization.htm).

“Argentina Since Default: The IMF and the Depression” by Alan Cibils, Mark Weisbrot, and Debayani Kar, *Center for Economic and Policy Research*, Briefing Paper, September 3, 2002 (http://www.cepr.net/argentina_since_default.htm).

“Análisis N° II: Argentina, el FMI y la Crisis de la Deuda” http://www.mecon.gov.ar/analisis_economico/nro2/2_fmi_crisis_deuda.pdf.

“Applying Economics to Economists: Good Governance at the International Financial Institutions” by Mark Weisbrot and Dean Baker, CEPR, July 2004 (http://www.cepr.net/publications/ifi_accountability.htm).

RESOURCES:

Jubilee Network

Web location: <http://www.jubileeusa.org/>

Center for Economic and Policy Research (CERP) in Washington, DC

Web location: <http://www.cepr.net/>

Centro Interdisciplinario para el Estudio de Políticas Públicas (Interdisciplinary Center for Public Policy Studies-CIEPP) in Buenos Aires,

Web location: <http://www.ciepp.org.ar/>

Alan Cibils, “Argentina and the IFIs: Better off Without Them?,” Americas Program (Silver City, NM: Interhemispheric Resource Center, October 20, 2004).

Web location: <http://www.americaspolicy.org/articles/2004/0410argentdebt.html>

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Recommended citation:

Alan Cibils, “Argentina and the IFIs: Better off Without Them?,” Americas Program (Silver City, NM: Interhemispheric Resource Center, October 20, 2004).

Web location:

<http://www.americaspolicy.org/articles/2004/0410argentdebt.html>

Production Information:

Writer: Alan Cibils

Editor: Laura Carlsen, IRC

Layout: Tonya Cannariato, IRC