

# The Dawn of a New Era?

By Alan Cibils | October 10, 2003

On September 9 Argentina defaulted on a \$2.9 billion payment to the IMF, setting off alarm bells in the conservative media and spurring joyful hopes among those who believe that the IMF is largely responsible for the Argentine crisis. The January 2003 agreement, which had rolled over Argentina's debt service to the Fund, had expired on August 30 and the new agreement had stalled when Argentine negotiators refused to agree to three IMF demands.

The first IMF requirement was that Argentina generate a 4.5% of GDP primary fiscal surplus (the fiscal surplus before debt service payments) in 2004, and larger surpluses in 2005 and 2006. Second, the IMF wanted the new agreement to include a timeline for increases in the privatized utility rates. Finally, the IMF wanted Argentina to start making capital payments on its \$15 billion debt to the institution, in addition to keeping up its interest payments.

Marking a strong departure from his predecessors, President Néstor Kirchner refused to accept these IMF demands, arguing that he would not sign an agreement that he could not comply with. The IMF finally backtracked on these demands and signed an agreement that included a smaller primary fiscal surplus for 2004 (3% of GDP, and no specific surplus values for 2005 and 2006), no timeline for utility rate increases, and no capital payments on Argentina's debt to the IMF for the duration of the accord.

The new agreement has been touted as an Argentine victory over the IMF. The right criticized the IMF for being too "soft" on Argentina and caving in to President Kirchner's demands. Many on the left believed that the dawn of a new era was at hand: it was possible to stand up to the IMF and live to tell of it.

### An Argentine Victory?

A thorough read of the agreement, however, presents us with a very different picture. Kirchner and Economy Minister Lavagna agreed to implementing a policy package and structural reforms that contain many of the historic IMF demands. In sum, this accord is yet another orthodox adjustment agreement aimed exclusively at getting Argentina to generate enough fiscal savings to transfer abroad as debt service. Once again, economic reactivation and development have been put on the back burner.

The best Argentina can hope for under this agreement is to limp along at low growth rates that will hardly make a dent in its 20% unemployment rate, 54% poverty rate, and 27% indigence rate. Under the conditions of the agreement, Argentina must once again postpone plans to reactivate its internal market through income redistribution and more equitable economic development.

The policies and reforms to which Kirchner and Lavagna committed include:

**Fiscal austerity:** The primary fiscal surplus that Argentina must achieve in 2004 is 3% of GDP or roughly \$4 billion. This surplus is 20% larger than the one required for 2003, and historically unprecedented in its magnitude. While no specific targets are set for 2005 and 2006, the agreement states clearly that that the upward trend in fiscal savings started in



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2002 will continue through 2006. In other words, rather than using fiscal resources to reactivate the economy and lower unemployment, the government will ship its scarce resources abroad as debt service.

**Tax reform:** Argentina has a highly regressive tax structure, where almost half of state revenue comes from a 21% sales tax, while interest income and capital gains are not taxed at all. The notable absence of any mention of a comprehensive tax reform in the agreement indicates that neither the IMF nor the Argentine government is worried about this. Furthermore, should the government fail to achieve the agreed-to surplus, it has committed to expand the application of the sales tax to more items. However, the agreement does stipulate the gradual removal of all taxes that “distort” the price structure, such as export taxes. This will eliminate a mechanism that has permitted the government to recapture some of the huge profits that the export sector has obtained since the January 2002 devaluation.

**Tight monetary policy:** As with most past IMF agreements, Argentina is expected to slow the growth of its money supply for the rest of 2003 and 2004. This is an inexplicable and unjustifiably restrictive monetary policy, since there are no signs of inflationary pressures, idle capacity stands at approximately 30%, and consumption is barely growing. The well accepted concept of “spending your way out of a recession,” which the conservative Bush administration has used liberally, is a foreign concept to IMF officials when dealing with Third World countries.

**Capital controls:** Since, according to the agreement, “financial stability has been achieved,” a “gradual removal of all remaining exchange controls” is stipulated. This directly contradicts the stated goal of “reducing exposure to external shocks.” Clearly the IMF has not learned much from its bumbling through the repeated financial crises of the 1990s—many country experiences have shown that capital controls are an excellent way of achieving financial stability.

**Public banks:** The January agreement set in motion the process for privatizing Argentina’s public banks.

The first step in this process was to be an audit of the banks to be carried out by a foreign consultant. The present agreement says nothing about privatization, but the audits must continue, and the recommendations of foreign consultants must be implemented. The language used is ambiguous enough so as to allow for multiple interpretations—including a requirement to fully privatize the banks, an historic IMF demand in Argentina.

**Financial reform:** Financial sector reform is described in general terms, except for the elimination of any flexibility in dealing with debtors in arrears. This, too, is a long-standing IMF demand, particularly with the mortgage segment of the credit market.

**Utility rates:** Privatized utility company rates have been frozen by law since the devaluation of 2002, and since this occurred, the IMF has become the main lobbyist to have these restrictions removed. To achieve this, the IMF wanted the current agreement to contain a timeline for utility rate increases, but the government refused to accept. Still, the agreement did specify that the Argentine Congress was to pass a law allowing the government to unilaterally increase utility rates. Always eager to please the IMF, the Congress did just that on October 1st.

Since the government has projected an 11% inflation rate for next year, it is widely believed that utility rates will increase shortly. Given the slow rate of economic recovery, and inflation at only 2.6% so far this year, it is difficult to explain the projected inflation rate for 2004 unless one expects utility rate to increase.

## What Next?

The agreement leaves unanswered important issues about Argentina’s future. First, many believe that the IMF needed this agreement far more than Argentina. Furthermore, Argentina could have defaulted to the IMF and would not have had its membership in the Fund revoked for two years. Why the hurry to sign an agreement with the IMF, particularly one that is

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so clearly damaging to Argentina's short- to medium-run recovery prospects?

Second, what is the Kirchner administration's strategy to get the economy growing at a rate that makes a significant dent in poverty and unemployment? A strategy that prioritizes income redistribution and the reactivation of domestic demand is clearly at odds with the government's commitments through 2006. The neoliberal ideology of the 1990s still dominates economic policymaking, despite the president's rhetoric.

Third, what specific reforms are planned for the public banking system? The economic and financial crisis from which Argentina is slowly emerging showed the importance of a strong public banking sector. Furthermore, public banks could be key players in the reactivation of the credit market for small and medium businesses currently strapped for credit. However, the vagueness of the language in the agreement is suspicious, since it would have been easy for the government to state its commitment to a strong public banking system had it so desired.

Fourth, what is the government's overall strategy vis-à-vis public debt? Public sector debt is currently \$180 billion, or 140% of GDP. If debt restructuring is successful, it will be reduced to 90% of GDP, still an unsustainable level. Therefore:

- \* What happens if creditors reject the debt restructuring offer made by the government on September 21? (The government offered a 75% debt reduction which creditors have, so far, rejected).
- \* Why is there no debt reduction for the International Financial Institutions (IFIs)? Private creditors bought risky Argentine government bonds, and they lost. But the IFIs also made bad loans. Furthermore, the IMF and World Bank imposed and funded the policies that led to the Argentine catastrophe, as President Kirchner himself has pointed out. It is therefore logical to expect that multilateral debt should also suffer a reduction.

- \* Almost half of Argentina's public debt is new debt issued by the government since the default and devaluation. A considerable part of this new debt is the result of the government taking on private sector dollar-denominated debt. This operation needs to be reexamined as many exporters, whose income is in hard currency, reaped undue benefits without any logical explanation.

Finally, the U.S. Treasury and the IMF have long acted in tandem to further their common interests. However, a rift between the Treasury and the Fund has emerged over how to deal with Argentina. While the IMF still favored making an example of Argentina, the Bush administration did not want to risk Kirchner going it alone and perhaps becoming another Hugo Chávez. Therefore, the U.S. pressured the IMF to back off on some of its demands. Argentina could have used U.S. support to bargain even harder with the IMF on some of the more controversial issues, but for unknown reasons it chose not to. This rift between the Bush administration and the IMF is an opportunity that both Argentine negotiators and those fighting for IFI reform in the U.S. can exploit against the IMF's orthodox policy prescriptions.

Argentina has once again signed an orthodox adjustment agreement with the IMF that results in the allocation of scarce resources for debt repayment rather than for economic reactivation. Unfortunately, the neoliberal economic model of the 1990s is alive and well in Argentina.

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