

The Implications of Argentina's Struggle with IMF Debt for Highly Indebted Poor Countries

Can Debtors be Choosers?

By Daniel Marx McCarthy | February 16, 2005

On February 4th and 5th, leaders of the G-7 nations convened in London to discuss options for ending the grievous cycle of debt that has plagued the world's most impoverished nations for years. Announcements and proposals prior to the meetings by officials from the United States and Britain calling for 100% cancellation of multilateral debt spurred optimism that a deal could and would be reached over the weekend. Unfortunately, disagreements between John Taylor, the Under Secretary of the U.S. Treasury, and Gordon Brown, Finance Minister for Britain over how to finance the cancellation prevented debt-laden nations from receiving the solutions they need.¹ Furthermore, the proposals on the table also failed to include provisions that would eliminate the contentious conditions attached to the current Highly Indebted Poor Country (HIPC) debt-sustainability framework that have caused fierce objections among some debtor nations.²

The dire need to solidify an effective agreement quickly in order to alleviate the burden of debt means that the failure by the G-7 to produce an acceptable solution may force indebted nations to explore alternative remedies. Some may look at Argentina's persistent resistance to the IMF's will to guide the highly indebted nation's repayment policies and find some clues on how to resolve their own debt problem.

Like HIPC nations, Argentina was faced with prodigious external debt owed to private and public creditors at the same time as it had to deal with economic and social chaos. This created a precarious dilemma for Nestor Kirchner's government: It could either become the first non-"pariah"³ state to default to the IMF and free itself from IMF conditional loans, or it could divert domestic income from its recovering economy for debt service to its creditors and continue co-piloting its economy with the Fund. So far, Argentina has successfully dabbled in each, which has allowed Mr. Kirchner to control his nation's debt destiny more effectively than most other governments that have faced similar circumstances.

The Argentina Story

Argentina's strategic resistance to the financial world's consensus on how it should restructure its external debt of \$103 billion to private creditors and almost \$15 billion to the IMF—provides a ray of light for poor nations looking to broker more favorable deals with the seemingly omnipotent IFIs. Typically, the World Bank and IMF maintain a near monopoly regarding loan agreements with borrowing nations because of an informal arrangement under which other IFIs, governments, and sometimes even private creditors won't lend without IMF approval. This unequal relationship allows the IFIs to prescribe their usual structural reforms and fiscal targets. Borrowers accept, often begrudgingly, because beggars can't be choosers. However, the Kirchner government has garnered exceptional power within the historically David vs. Goliath negotiations by playing the default card, which immediately caught Goliath's attention.

The IMF has called on Argentina, the Fund's 3rd largest borrower, to repay its public debt over the next four years.⁴ However, Mr. Kirchner claims that his government cannot afford this financial squeeze during its current recovery period and has called on



the IMF to extend the service horizon to six years.⁵ Typically, the IMF squashes such overtures, but Argentina's tough bargaining with its private creditors has complicated the IMF's position.

The Fund has been forced to pay interest to the commercial debt restructuring process, since the outcome of the deal will directly affect its future in Argentina and elsewhere. This is because, according to the IMF charter, the Fund cannot lend to a nation that is in arrears with its private creditors, and is acting in bad faith (defined as when a debt-restructuring offer garners only a miniscule acceptance rate from creditors). Argentina has recently claimed an acceptable rate would be 50% while the IMF believes around 80% acceptance would warrant the "good faith" label.⁶

Furthermore, Argentina already stated that it expects a new round of IMF negotiations following the restructuring deal. Therefore, Argentina has forced the IMF into either labeling its impending private sector deal in good faith whatever—the final acceptance rate from creditors—and honor the nation's request for a two-year extension on the \$15 billion IMF debt in new negotiations, or conclude the offer is unacceptable, thereby eliminating the prospect of future lending. However, the second option could very well infuriate the headstrong Kirchner and provoke a default on the \$15 billion IMF debt. Either outcome would land the Fund in uncomfortable—and unfamiliar—territory. On the other hand, it would also award Argentina relative success as the government could either save substantial income by defaulting, or gain needed time to service its debt payments.

Can Other Debt-Laden Nations Beholden to the World Bank Play the Default Card?

Argentina's economic recovery since the crisis in 2001 has been extraordinary, as GDP grew 8.8% and 8.7% in 2003 and 2004 respectively, while unem-

ployment has declined from 20% to 13%.⁷ Remarkably, all of this has occurred without any new money from the IMF. However, a recovery without new loans is a rare occurrence that stems from the auspicious trade and current account surpluses Argentina has experienced since 2001.⁸

At least eight of the 35-40 HIPCs also are experiencing current account and trade surpluses and therefore are the only potential candidates for Argentina-style bargaining.⁹ Conceivably, these nations could experiment with the threat of default if the G-7 does not agree to cancel their debt and if they believe the heavy hand of a condition-filled program is damaging their economy.

The failure by the G-7 to produce an acceptable solution may force indebted nations to explore alternative remedies.

However, defaulting poses substantial risk since international capital, which is undeniably important for growth, would almost certainly avoid uncooperative countries. A much more powerful approach calls for indebted

nations to organize to form a bargaining cooperative that represents and supports the interests of weaker, poorer states against the creditor cartel of the World Bank, the IMF, and private creditors. With this support structure in place, a surplus-blessed nation could threaten to default on its loans, knowing that it would have the support of its allies if it actually did default. Furthermore, default is not a desirable option for anybody and creditors would likely flinch if debtors seriously exploited this fear.

Time to Pull the Plug?

Argentina has demonstrated that debt-burdened nations in crisis can exert their will against the IFIs and win freedom from imposing conditional loan packages. By invoking a credible threat of default on its IMF debt through a clever private-debt restructuring campaign, the government has forced the Fund to capitulate. Furthermore, as Hans Humes, co-chairman of the Global Committee of Argentina Bondholders and fierce critic of the Kirchner

approach recently remarked, “If Argentina’s offer succeeds it will dramatically lower the cost of defaulting and strip power from creditors. All borrowers—not just sovereigns—will be much more tempted to pull the plug.”¹⁰ As G-7 finance ministers and IFI officials in London failed to reach an accord on multilateral debt, HIPC’s continue to wait silently for their prescription. If the medicine does not arrive soon, it may be time to exploit Mr. Humes’ fear and explore Argentina’s strategy.

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ENDNOTES

¹ Recently, Gordon Brown, the finance minister for Britain, has proposed financing cancellation through creation of the International Finance Facility, which would be financed with revaluation of IMF gold along with increased donations from wealthy nations. (See “Canada backs debt write-off,” the *Guardian*, 2/3/05 for more info.)

The World Bank has taken the position that it can fund a swap from loans to grants for 40 nations and offer a mix of loans and grants to an additional 12 less-poor countries. (See “World Bank Plans to Shift Aid; Move from Loans is Major US Goal,” Paul Blustein, *The Washington Post*, 1/14/05.)

The United States has promoted canceling 100% of multilateral debt by mobilizing resources from the IMF’s Poverty Reduction Growth Facility and reserves and net income from the World Bank Group. (From recent statements at a public debt cancellation forum entitled, “Dropping the Debt, Footing the Bill: Debt Cancellation and Financing Options.”)

Jubilee research has supported mobilizing IMF gold and increasing dona-

tions from wealthy nations as the ideal option, but also supports utilizing IBRD resources should the first two options fail. (See “World Bank (IBRD) Resources and Debt Cancellation,” Sony Kapoor. Jubilee USA Network.)

- ² For more information on debt sustainability and its conditions see, “HIPC: Flogging a Dead Process” <http://www.jubileeusa.org/resources/reports/deadHIPC.pdf>.
- ³ Past “pariah” or “failed” states include Congo, Iraq, Afghanistan, Somalia, Sudan, and Liberia.
- ⁴ In practice, the current agreement functions such that Argentina must regularly service its IMF debt at the rate of 3% of GDP, but the IMF, in turn, rolls over this repayment, provided Argentina is in compliance with the fiscal and monetary conditions of their accord.
- ⁵ “Argentina goes head to head with IMF on loan extension” Andrew Balls and Adam Thomson, *The Financial Times*, 2/2/05.
- ⁶ “Creditors cry foul over debt as Argentina changes rules,” Adam Thomson, *The Financial Times*, 1/12/05.
- ⁷ “Argentina: El Ministerio de Economía estima que el PIB crecerá un 5,5 por ciento en 2005,” Reuters, 1/24/05.
- ⁸ In 2002 Argentina experienced a trade surplus of 21.8% of GDP and current account surplus of 12.5%. Healthy indicators such as these negate the need for foreign capital inflows, and the IMF’s mission is in fact to loan when nations face a balance of payments crisis. For more details, see “Argentina since the default,” Mark Weisbrot and Alan Cibils. Located at: http://www.cepr.net/argentina_since_default.htm
- ⁹ Global Development Finance 2004, The World Bank. In 2002 the eight HIPC nations that had current account and trade surpluses were: South Africa, Nigeria, Morocco, the Democratic Republic of Congo, the Republic of Yemen, Cote d’Ivoire, Bangladesh, and the Philippines.
- ¹⁰ “Creditors cry foul over debt as Argentina changes rules,” Adam Thomson, *The Financial Times*, 1/12/05.

Argentina’s strategic resistance to the financial world’s consensus on how it should restructure its external debt provides a ray of light for poor nations.

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