

What Next for Argentina?

Edwin M. Truman
Institute for International Economics

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Two years ago, a series of misguided decisions by its political leadership plunged Argentina into economic and financial chaos. A serious situation rapidly deteriorated. Over the past 18 months, greater stability and a resumption of growth have been achieved. However, the international financial community is increasingly frustrated by Argentina's slow progress in renegotiating utility rates, reconstructing the banking system, and, in particular, regularizing its external debt payments.

Argentina's slow progress has undercut the credibility and authority of the International Monetary Fund (IMF), in the process calling into question the unwritten ground rules of international finance. The management of the IMF, preferably with the support of the G7 nations, should adopt a proactive two-part, offensive-defensive strategy to deal with this dangerous situation. First on offense, the IMF should provide the Argentine authorities with its bottom-line judgment on what would be an acceptable rescheduling of Argentina's external debt. Second on defense, the IMF should update its general policies to deal with substantial arrears to it by a major borrower.

On the Argentine debt negotiations, the IMF should shift its focus from process to substance. Argentina and the representatives of holders of its defaulted debt so far have engaged in a dialogue of the deaf. Simply put, Argentina is sticking with its Dubai offer of new debt at a face value of 25 cents for a dollar of old debt, and the bondholders are at 65 cents. The IMF management must not sit back and let nature take its course. A proactive strategy is needed to bridge the gap.

The IMF management should provide the Argentine authorities with the broad parameters of a deal that it would support. The IMF's judgment on the deal should be based on a debt sustainability analysis and accompanying recommendations with respect to macroeconomic policies. The IMF need not, and should not, specify all the details of the deal.

The IMF will be expected to pronounce publicly on Argentina's formal offer. The sooner the IMF decides what is acceptable and communicates that judgment to the Argentine authorities, the better. Of course, the IMF's position need not be made public until any offer is formally announced.

Thus, for example, the IMF might say to the Argentine authorities that the face value of the new debt should be around 45 percent of the face value of the old debt, interest rates and principal payments should be somewhat back loaded, and any positive or negative

economic surprises for Argentina should be shared by the bondholders. Alternatively, the IMF could specify, possibly, a range for an acceptable and sustainable payment stream, which could be deduced from its macroeconomic and debt-sustainability analysis. The bells and whistles in any actual offer should be left to the Argentine authorities, preferably after consultations with the bondholders.

Bringing Argentina and its creditors to the table to discuss a deal whose broad parameters have been specified would help to address a type of collective action problem. It would help bridge the present gap between the IMF's current rhetorical requirement of "good faith" negotiations and the bondholders' articulated concerns about "fairness" and promote substantive engagement. Meanwhile, the G7 should support the IMF management in this initiative and stop pretending that this is a matter that can safely be left to Argentina and its creditors. The G7 nations have systemic interests in the terms of any rescheduling. Regardless of the G7's attitude, the IMF should move forward.

The IMF strategy should be defensive as well as offensive. On the defensive side, the IMF management should immediately put forward proposals on how to deal with large arrears by major borrowers, should they develop, and insist on prompt IMF Executive Board action on them.

To the extent that the Argentine authorities have been using the threat of arrears to force IMF endorsement of their economic and financial policies, which is certainly the widespread perception, an IMF arrears initiative would signal that any leverage has been lost. The arrears proposals presumably would involve raising the interest rates the IMF charges borrowers, lowering the interest rates that it pays creditors (principally the G7 countries), and reducing transfers from its profits for other uses.

In case of Argentine recalcitrance to use its reserves to repay its IMF obligations, the defensive element of the IMF strategy would demonstrate to the world that Argentina thereby would be imposing a burden on the entire membership of the IMF. Again, the G7 should wholeheartedly support the IMF management's initiative in this area. They should also immediately encourage the World Bank and Inter-American Development Bank to put similar policies into place.

For the past two years, the international financial community has been right, on balance, to give the Argentine authorities the overwhelming benefit of the doubt as they sought to deal with Argentina's serious economic and financial problems, including its unsustainable external debt. There have been false starts and dissents, but on the whole Argentina has gotten what it wanted. Now Argentina must get serious.

The IMF and the G7 also must take seriously their responsibilities for the health and stability of the international financial system and its institutions, such as the IMF. The two-part strategy that I have outlined, building on Argentina's internal economic progress, should help ensure that the Argentine financial situation does not spin out of control and damage the global economy and financial system as well its institutions that were established to nurture it.