The frequent and sudden change of a number of Argentine Presidents, since December 20, 2001 and its economic default on its $141 billion foreign debt indicates a major economic and political crisis for the country. Its repercussions are likely to engulf Argentina for the foreseeable future, in the politics of instability. The crisis is linked to the bad governance and erroneous economic policies adopted and pursued over a decade with the backing of the IMF. With a simultaneous currency and debt crisis the fundamental challenge confronted by President Eduardo Duhalde's government is how to restore economic stability, given the fact that there is very limited maneuverability due to various politico-economic constraints that have arisen.

The economic crisis in Argentina not only holds serious implications for the lending policies of the IMF, but also strengthens the fears of anti-globalisation forces regarding the way developing economies have been forced to follow economic liberalisation. However, this does not absolve the respective governments in developing economies from blame for their bad governance while implementing these policies.

Present Economic Situation

Argentina's default was long predicted, given its economic indicators, such as the consecutive recession within its economy since 1999 - GDP growth at -4%, unemployment rate at almost 20%, 14 million Argentines living below poverty line and one of the lowest export to GDP ratio at less than 10%. Presently, following the political turmoil through the latter part of 2001, Argentina's economy is in stagnation, with strict capital controls, since December 21, 2001, on foreign exchange transactions as well as a partial freeze on currency withdrawals, to avoid capital flight and excessive dollar withdrawals. President Duhalde has devalued peso by 29% and has introduced a dual exchange rate policy while abandoning the decade long dual currency system with peso and dollar operating at 1:1 ratio. Violent protests have erupted across the nation following middle class frustrations due to economic uncertainty.

Economic Policies During 1990s

During the decade of the 1990s, two salient features of Argentina's economic policies were an aggressive economic liberalization carried out through privatization, and deregulation (banking system and foreign investment) and the pegging of the peso to the dollar under a 'currency board system'. These policies were meant to bring economic stability in the country and to mitigate the huge impact from a 5000% hyperinflation of the 1980s. The 'currency board system' required that each peso in circulation be backed by the equivalent in foreign reserves, and could thus be converted at one-for-one for the US dollar. In the short run, these policies did bring economic stability in the country through increased economic growth, reduced inflation, improved fiscal discipline and the luring in of foreign investments.

However, this economic stability proved short lived, as successive governments failed to increase industrial competitiveness, in the absence of necessary reforms, especially in the labour market. On the other hand, fiscal profligacy involved in privatisation process of the State Owned Enterprises (SOEs) favouring incompetent foreign companies proved contrary to the objective of liberalisation. An overvalued currency relative to the currencies of its trading partners crippled Argentina's industry and export sector, making the economy unsustainable to external shocks (such as devaluation of Brazilian Currency in 1999), which in turn led to high levels of unemployment.

These downward trends coalesced with inefficient management and high fiscal deficit, which in turn led to an increased debt burden in the 1996-2001 period. In the aftermath of the East Asian Crisis of 1997, the reduction in the foreign investment flows to emerging economies[1],such as Argentina, led to excessive borrowings in the absence of sufficient tax revenues. Cut off from credit, the country entered into a deflationary spiral. The government's effort to impose austerity measures culminated in the lack of public confidence in currency, resulting in panic withdrawals from banks. As a safeguard measure, the government imposed a limit of 1000 pesos per month on cash withdrawals from the banks in December 2001, which ultimately resulted in public demonstrations and riots, killing 27 people that led to a political crisis.

The IMF Role

Argentine's economic default on its foreign debt has revived the debate over the role of the IMF. The Argentine government's failure to implement austerity measures of the IMF led to the IMF's refusal to release $1.3 billion credit to Argentine and its consequent default on December 21. One of the criticisms of this default is that the IMF's over-lending to Argentina's successive governments, despite unsustainable policies of the latter, was the major factor in exacerbating the external debt. The IMF recommended a $8 billion increase in its $14 billion stand-by loan in August 2001 when the international credit rating agencies slashed Argentina's credit rating. One of the theories propounded by economists is that banks' actual profit is the 'perpetual interest' and not the principal amount to be repaid, therefore the banks keep on lending to secure its interest payments.[2] Argentina case precisely fits to this thesis of Griffin, as a $20 billion bailout deal, is expected to be negotiated between Argentina and the IMF, very shortly, conditioned by a stable economic recovery plan with a floating exchange rate. The IMF has also postponed Argentina's $933 million loan repayment for one year, due on January 17. However, given Argentine's very high country risk assessment by JP Morgan - an international credit rating agency - it can only borrow at an extremely high interest rate. This is also linked to the fact that why various debt relief initiatives from the 'Brady Plan' of 1989 [3], to the present Highly Indebted Poor Countries (HIPC) Initiatives' of 1996 and 1999 have not been successful so far. Few countries that have availed the facility have rather ended up with an increased debt burden. These outcomes question the seriousness of these debt relief initiatives.

There is also a political dimension to the issue. The IMF and other international financial institutions are regarded as tools of neo-colonial policies of the big powers, which control the IMF decision making. The IMF's perpetual lending ensures the developed countries control and influence over the policies of the developing countries. This has drawn a focus on IMF's lending policies, as Argentina was once a stark example of the successful implementation of liberalisation policies. The IMF conditionalities create social unrest and political disruption when the national governments try to implement these conditions. This holds especially true for economic liberalisation policies based on 'Washington Consensus'[4], forced as a condition on many developing countries during 1990s, to get IMF's credit, without considering their levels of economic and social development. Even recently, IMF's proposed austerity measures such as legislation on zero budget deficit and holding back of government spending at a time when the economy was contracting and needed more liquidity to be injected, proved politically suicidal for Argentina's government.

However, the IMF refuses to share any responsibility for the crisis and rather defends its position through a counter argument, such as the Fund itself being threatened by greater global and regional, economic turmoil, should it not continue with its lending policies and conditionalities. The institution, through its own resources and research staff can well calculate the economic situation and does not need to rely on the propositions of the borrowing countries.

Economic Recovery and Future Implications

In the aftermath of economic default on its foreign debt of $141 billion[5], the Argentina government had the following options available for the currency stabilisation:

- To devalue the peso and bring it to the real value against the dollar.
- The other option, mainly propounded by Americans is complete dollarisation of the currency, just as Ecuador did in the year 2000, after its economic default.[6] The option seems impractical due to lack of enough dollars to buy 10 billion pesos in circulation.

The interim government of President Saa, who took office on December 21, 2001, after the political crisis, introduced an economic stability plan. It consists of introducing a new pseudo currency called ‘Argentino’, and to create one million jobs through public works programmes, as a part of emergency measures. The plan appeared to be part of President Saa’s political agenda to get votes in the coming elections, in March 2002. However, the financing of fiscal deficit and public spending through excessive issuance of the third currency could have revived hyperinflation thus leading to severe disorders in the monetary policies. The disagreements over the third currency among the interim cabinet members led to the resignation of the President Saa, thus deepening the economic crisis further.

The new President Mr. Eduardo Duhalde, elected on January 1, 2002, while continuing with the default and social work plans of his predecessor interim government, has replaced the convertibility policy with a ‘dual exchange rate policy’ through the devaluation of peso. The dual exchange rate i.e. officially pegged and unofficially floating exchange rate will be difficult to control and may induce corruption. An effective dual exchange rate policy requires a careful implementation, with significant management machinery. While the devaluation was an unavoidable solution for long-term economic recovery, the policy can have following short to medium term implications:

- Devaluation can drive widespread bankruptcies in the country, as wages are paid in pesos but more than 80% loans are denominated in dollars, which in turn can render the whole banking system insolvent. However, to avoid bankruptcies the government’s plan to convert loans up to $100,000 into pesos, will inflict serious damages upon the foreign banks operating in Argentina. According to Moody's Investors Service Report, an international credit rating agency, released on January 18, Argentina's banks face losses of $54 billion and may be taken over by the government to avert financial collapse. Government’s plan to impose new taxes on oil exports will not only be insufficient to offset the losses of such a high magnitude, but will inflict heavy damages on foreign companies. Similarly, foreign investors such as Spanish companies with heavy investments in Argentina, which have been barred from charging in dollars as well as from indexation of rates to US inflation, will suffer from the fallout by at least 30%.
- Devaluation means that the country’s foreign debt as well as cost of imports would be multiplied manifold. Increase import prices can hit the industry dependent on foreign raw

material. Although the move would help stimulate the export sector, but having 10% share of the GDP, the stimulative effect will be too little to offset the contraction created by the bankruptcies and default. Although a dual exchange rate can be distorted for exports, but a completely floating exchange rate may lead to too much depreciation leading to hyperinflation experienced in 1980s. Although Mexico in 1995, and Brazil in 1999, despite short-term problems, successfully managed floating exchange rate policies, but Argentine's economy is different from the two regional countries. The most important factor is to have credible inflation target accompanied by structural reforms such as a fair and efficient tax system.

In the given economic situation, there are fears of social dislocation especially for the middle class of the country. Similarly there is risk of reduction in the international investment in the country and even existing investors can move to other regional countries. Over all, Argentina's crisis could not trigger the global economic crisis at par with 1997-98 economic crises, in Thailand and Russia, as peso had already become widely discounted in the markets, given the country's long recession. However, in the short term, Argentina's decline will affect the export performance of other regional countries especially Uruguay, which depends totally on trade with Argentina. Also MERCOSUR - the Latin American regional trade agreement - will be under great strains due to Argentine's economic crisis.

The crisis has, however, built a strong case against the 'Washington Consensus' policies of market liberalisation, privatization and deregulation, supported by the international financial institutions during the 1990s. On the economic front, it holds many lessons for developing countries with heavy debt burdens and for their embracing free market reforms under the pressure of international financial institutions. Liberalisation in the developing countries should be through a gradual process, considering their domestic levels of economic development and adjustment costs associated with economic transitions. Domestically, a combination of good governance in economic and political institutions, reduced dependence on international borrowings through an efficient and effective tax base, containing fiscal deficits to a sustainable limits and a competitive exchange rate regime.

References

1. Emerging economies are the economies, which are in transition to the free market economy.

2. G. Edward Graffin in his book "The Creature from Jekyll Island" has presented a model of the complicated process of perpetual interest and bail outs.

3. Brady Plan was based on rescheduling or writing off some of the debts for larger debtor countries, so that they had less to pay. However, in terms of total debt stock this plan has not helped debtor countries.

4. 'Washington Consensus' is based on the thesis that the policies of market liberalisation, privatization and deregulation are the basis for economic growth.

5. The figure is as on 3rd of January when the government of Argentina officially confirmed its default.

6. The suggestion was made by Steve Hanke, a John Hopkins Economist and an advisor to President Carlos Menon of Argentina in 1990s.

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