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The IMF and Argentina's Spiraling Crisis

By Arthur MacEwan

"After our trip to Buenos Aires," the investment firm of Merrill Lynch announced in early July, "our main impression is that the risks of a spiraling of the crisis in Argentina have increased." Investors took the warning to heart. On July 11, in its efforts to raise funds on the bond market, the Argentine government was forced to offer interest rates of 14% on its three month bonds; only two weeks earlier, investors had demanded only 9% for similar bonds.

Not long ago, Argentina was the poster-child for the free market, conservative economic policies pushed by the International Monetary Fund (IMF). The Buenos Aires government privatized state enterprises, liberalized foreign trade and investment, and tightened government fiscal and monetary policy. During the 1990s the country's economy seemed to do well. It now turns out, however, that the good times of the 1990s were built on weak foundations. Economic growth in that period, while substantial, appears to have been in large part the result of an increasing accumulation of international debt, fortuitous expansion of foreign markets, and short term injections of government revenues from the sales of state enterprises.

Things Turn Sour

Toward the end of the decade, things turned sour. By mid-2001 Argentina was into its third year of recession, and its financial problems were threatening the stability of other "emerging markets." The unemployment rate has risen above 15%, worsening the impact of the increasing income inequality that has characterized the whole IMF-dominated era in Argentina. Not surprisingly, the president's approval ratings have plummeted and street actions by workers are on the rise.

Argentina's problems are all the more severe because, in the name of fighting inflation, in the early 1990s the government created a "currency board," charged with regulating the country's currency so that the Argentine peso would exchange one-to-one for the U.S. dollar. To assure this fixed exchange rate, the currency board maintains dollar reserves, and cannot expand the supply of pesos without an equivalent increase in the dollars that it holds. The currency board system appeared attractive because of absurd rates of inflation in the 1980s, with price increases of up to 200% a month. By the mid-1990s, inflation in Argentina had been virtually eliminated—but flexibility in monetary policy had also been eliminated. When the current recession began to develop, the government could not expand the money supply as a means of stimulating economic activity. Worse yet, as the economy continued downward, the inflow of dollars slowed, restricting the country's money supply even further (by the one-to-one rule). And still worse, in the late 1990s, the U.S. dollar appreciated against other currencies, which meant (again, the one-to-one rule) that the peso also appreciated; the result was a further weakening in world demand for Argentine exports.

Failure under the Direction of the IMF

Economic policies in Argentina during the past 15 years have had substantial support among the country's business elite, especially those whose incomes derive from the financial sector and primary product exports. These groups have gained substantially, and officials in the Argentine government have been active in formulating and executing the policies that have led to the current debacle. At the same time, the

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country's economic policies have been developed under the direction of the IMF.

From the late 1980s onward, a series of loans have given the IMF leverage to guide Argentine policymakers as they have increasingly adopted the Fund's conservative economic agenda. As the country has entered into the lasting downturn of the current period, the IMF has continued, unwavering, in its support. The Fund provided Argentina with "small" loans, such as the $3 billion made available in early 1998, when the country's economic difficulties began to appear. As the Argentine crises has deepened, the IMF has increased its support, supplying a loan of $13.7 billion and arranging $26 billion more from other sources at the end of 2000. As things worsened still further in the summer of 2001, the IMF pledged another $8 billion.

The continuing IMF largess has been coupled with the condition that the Argentine government maintain its severe monetary policy and continue to tighten its fiscal policy. Deficit reduction—which according to the fund is the key to macroeconomic stability, which in turn is supposed to be the key to economic growth—is being undertaken with a vengeance. On the eve of its July 11 bond offering, government officials announced budget cuts of $1.6 billion (about 3% of the federal budget), hoping that these cuts would reassure investors and allow interest rates to fall. Apparently, however, investors saw the cuts as another sign that the country's crisis was worsening.

Argentina is providing one more example of the failure of IMF policies to establish the bases for long-term economic growth in low-income countries. Numerous other countries demonstrate similar sets of problems: much of sub-Saharan Africa, Mexico, and several other countries in Latin America, Thailand, and other parts of East Asia hit by the 1997 crisis, and Turkey along with Argentina in mid-2001. IMF policies often succeed in curtailing inflation; sharp cuts in government spending and restrictions of the money supply will usually yield reduced price increases. Also, IMF programs can provide large influxes of foreign loans—from the Fund itself and the World Bank, from the U.S. government and governments of other high-income countries, and, once the approval of the Fund has been attained, from internationally operating banks. But nowhere has the IMF policy package led to stable, sustained economic expansion. Often, as in Argentina, it generates growing inequality.

The IMF's mania for reductions of government spending in times of crises, such as in the current debacle in Buenos Aires, is rationalized by the claim that balanced budgets are the foundation of long-term economic stability and growth. That these policies have a severe impact on low-income groups (because they both generate high rates of unemployment and eviscerate social programs) is lamentable, according to the Fund, but necessary to assure long-term stability. Nonsense. In recessions, moderate government deficits (like those in Argentina) are a desirable countercyclical policy, and balanced budgets only exacerbate the downturn. Also, curtailing social spending—on education, health care, physical infrastructure projects—cuts the legs out from under long-term economic progress.

Why Does the IMF Stick to Failed Policies?

Yet the IMF sticks to its policies, probably because those policies serve important and powerful interests in the U.S. and world economies. The IMF, after all, is not an institution controlled by either the people or the governments of low-income countries. It is not even like UN agencies, where governments have formally equal voice with one another. Instead, the IMF is controlled by the governments of high-income countries that provide the funds for its operations. The U.S. government has by far the greatest influence at the IMF. With over 18% of the voting shares in the Fund, the U.S. government has de facto control. Indeed, over the years the IMF has operated largely as a branch of the U.S. foreign policy apparatus, attempting to create a context that assures the well being of U.S. interests—which is to say the interests of U.S.-based internationally operating firms. (The same context serves the interest of firms based in Europe, Japan, and elsewhere; so the U.S. generally has the support of its allied governments in directing the IMF.)

Most important, the IMF tells governments that a key to economic growth lies in providing unrestricted access for imports and foreign investment. Virtually all experience, however, suggests the opposite—that extensive regulation of foreign commerce by a country's government has been an essential foundation for successful economic growth. Britain, the U.S., Japan, countries of Western Europe, Taiwan, South Korea—all built the foundations for development not on "free trade" but on government regulation of trade. The IMF gets around the inconvenient facts of history by conflating free

trade with extensive engagement in the international economy. But the two are not the same. Yes, successful development has always been accompanied by extensive international engagement, but through regulated commerce and not free trade.

The dramatic experience with financial capital demonstrates a similar disconnect between IMF proclamations and reality. Through the period of its increasing influence in the 1980s and 1990s, the IMF pushed governments in low-income countries to liberalize their capital markets. Capital controls were, claimed the IMF, anathema to development. Then came 1997, when the open capital markets of East Asian countries were instruments of disaster. In the aftermath of 1997, it seemed clear that the real winners from open capital markets were financial firms based in the U.S. and other high-income countries.

These same financial firms are also the winners from another component in the IMF policy package. Fiscal responsibility, according to the IMF, means that governments must give the highest priority to repayment of their international debts. In fact, the immediate justification of new IMF loans is often that this influx of capital is necessary to assure prompt payments of past loans. While there is no doubt that banks operating out of New York and other financial centers gain from this policy, experience does not support the contention that when governments fail to pay foreign debts they bring on financial disaster. Instead, experience suggests that, at times, defaulting on foreign debt can be an effective, positive policy option. (Also, as has been frequently noted, as long as the IMF provides the funds to assure payment of loans made by the internationally operating banks, those banks will have no incentive to assure that they are making sound loans.)

IMF advocacy of privatization is one more example of its effort to open more fully the world economy for U.S.-based firms. When state enterprises in low-income countries are sold, large internationally operating firms are often the buyers, able to move in quickly with their huge supply of capital. Of course, in Argentina and elsewhere, local business groups have often been the direct beneficiaries of privatization, sometimes on their own and sometimes as junior partners of firms based abroad. Either way, whether the buyers of state enterprises are national or foreign, this enlargement of the private sphere of operation works to the benefit of the private firms. The problem here is not that privatization is always inappropriate, but simply that, contrary to IMF nostrums, it is not always appropriate. Privatization is especially problematic when it only replaces an inefficient government monopoly with a private monopoly yielding huge profits for its owners. Moreover, the record from Mexico City to Moscow demonstrates that privatization is often a hugely corrupt process.

A Growing Popular Opposition

The policies of the IMF and those of the World Bank have generated a great deal of popular opposition in low-income countries as well as in the U.S. and Europe. During recent years, that opposition has become increasingly strident, staging major demonstrations at meetings of the Fund and the Bank, as well as at other gatherings of the government officials guiding globalization. This opposition has been dubbed the "anti-globalization movement." The title is misleading because most of the activists are not opposed to the growing international economic and cultural connections among peoples, but are opposed to the way those connections are being structured, benefiting large firms while creating hardship and instability for many, many people. Policies like those of the IMF in Argentina typify the problem.

Pressure from this movement has had some impacts. The IMF's contribution to the Asian financial crisis in 1997 unleashed a torrent of criticism that the movement both built upon and contributed to. While no major policy changes have ensued, the Fund has responded rhetorically, renaming its "Enhanced Structural Adjustment Facility" as the "Poverty Reduction and Growth Facility." Over a longer period, the World Bank has also adjusted at least the appearance of its policies, focusing more attention on the issue of poverty and starting to examine the role of gender in economic development. The Bank, in addition, has backed off from some of its large-scale water control projects in low-income countries as a result of pressure from local organizations and international environmental groups. These changes have not basically altered the programs of the international financial institutions, and the IMF has been especially resistant to change. Yet these adjustments do suggest that opposition has begun to have an impact.

The lesson is that the movement for change should increase its pressure on these institutions that are playing such central roles in shaping globalization. While the movement has emerged largely in response to the hardships and inequality that have grown even while IMF-type policies generated some economic growth, this opposition will gain greater legit-

imacy as growth is replaced by crisis as is now happening in Argentina. The appeal of alternative policies will be even greater as the IMF and local elites can no longer claim that economic growth will eventually solve all problems.

Beyond Denunciation: Alternative Strategies

There is, however, a need and an opportunity for the opposition movement to go beyond denunciation of the IMF's conservative policies and to articulate alternative strategies, strategies that would support a democratic, egalitarian form of economic development. Such strategies would promote structural adjustment in low-income countries, but a very different and more fundamental structural adjustment than has been advocated by the IMF. A democratic development strategy could begin with a focus on the expansion of social programs, a greater investment in schooling, health care, and other public services that would establish a social foundation for long-run economic expansion.

A democratic strategy would not ignore macroeconomic stability, but instead of seeking that stability in government cutbacks it would pursue expanding the government revenues (raising taxes) as a means to provide fiscal balance. Also, a democratic strategy could not ignore the private sector, but it would recognize the problems of allowing the private sector to be guided simply by private profits in an unregulated market. It would, for example, push the private sector toward high-technology activity instead of production based on low-wages, and it would seek to provide support for local farmers to maintain their livelihoods and community stability.

The first problem in implementing an alternative development program in Argentina and elsewhere is to overcome the power of elite groups that have directed the existing system. In spite of the current difficulties, the policies that the Argentine government has followed in recent years, and the similar policies pursued by the governments of many low-income countries, have delivered substantial benefits to local elites. Those policies have allowed them to strengthen their positions in their own economies and secure their roles as junior partners with U.S.-based and other internationally operating firms. Changing policies will therefore require changing the balance of power. Shifting the balance of power in a country is never easy, but the emergence of an international movement for change and the growing economic crisis presents some substantial opportunities.

If people in low-income countries are to move in an alterative direction, they must find ways to deal with the oppressive burden of foreign debt. Not only is the debt itself a problem, creating a growing drain on countries' resources, but also the need to continually seek new debt in order to repay old debt forces governments to accept the IMF conditions that perpetuate the problem.

Here, those forces that want change can take a lesson from the high-income countries. As the governments of high-income countries work together in pursuing their economic relations with the low-income countries, low-income debtor countries have a common set of interests that could provide the foundation for common action. Working as a bloc, they would have a greater chance of gaining better terms, greater leeway in the conditions that come with foreign finance, and the freedom to pursue the sort of meaningful structural adjustment of a democratic strategy.

Ultimately, the power of such a bloc would depend on its willingness of member countries to repudiate their foreign debts. Such repudiation would have legitimacy because of the coercive practices that have given rise to this debt, and repudiation would have wide popular support. Would it, however, invite economic disaster? Unlikely, as debt defaults in the past have not generated such disaster. In any case, if forces in debtor countries could make the threat real, actual repudiation would probably not be necessary. The power that the high-income countries have in the threat to cut off new loans would be matched by the power that low-income countries would have from their threat to cut off the flow of repayments.

There are substantial political barriers to the emergence of democratic development strategies in low-income countries and to joint action by debtor countries. The policies of the IMF are not only backed by the U.S. government and its allies, but also by powerful elites in low-income countries. Yet the economic case for change is overwhelming, and one way or another a political route to this change needs to be found.

(Arthur MacEwan <arthur.macewan@umb.edu> is professor of economics at the University of Massachussets in Boston.)