11-1-2002

IMF Policy and the Argentine Crisis

John V. Paddock

COMMENT

IMF POLICY AND THE ARGENTINE CRISIS

I. INTRODUCTION: ARGENTINA'S ECONOMY IN THE 1990S

In the early 1990s, Argentina was suffering from a 200% monthly inflation rate with high tariffs and low productivity.[1] In an effort to tame inflation and attract foreign investment, Argentina stabilized its currency by pegging it to the U.S. Dollar.[2] To the extent the Dollar crept upward in the 1990s in relation to other currencies, the Argentine Peso also began to appreciate and imports became cheaper. The establishment of a currency board, which pegged the Peso to the Dollar, succeeded in making imports cheaper and curbing inflation.[3] However, the appreciation of the Peso placed exports at a comparative disadvantage.[4] At least in theory, domestic producers would have been forced to become more competitive in order to compete with inexpensive imports.

1. *Economic Conditions*, POLITICAL RISK SERVICES, Dec. 1, 1993, LEXIS, News Group File [hereinafter *Economic Conditions 93*].

2. Robert Tracinski, *Argentina's Intellectual Collapse: How IMF Policies Ruined Argentina's Economy*, CAPITALISM MAGAZINE, Jan. 7, 2002, *available at* http://www.capitalismmagazine.com/2002/january/rwt_argentina.htm.

3. *Economic Conditions 93*, *supra* note 1.

4. Paul Krugman, *Argentina: Money Monomania*, *at* http://www.wws.princeton.edu/~pkrugman/mania.html.

The currency regime attracted capital by providing foreign investors with confidence that contracts in foreign currency would be honored even during economic slowdowns.[5] Borrowers were more easily able to pay back loans from foreign creditors because they were able to buy dollars with the equivalent quantity of pesos.

Although the currency board had success in bringing inflation under control and increasing foreign investment, Argentina's eight-year recession left the Peso substantially overvalued.[6] During this period Argentina's GDP either remained stagnant or decreased because of a decline in exports due to protectionism in major markets and an overvalued Peso pegged to the rising Dollar.[7] Further, the pegged rate gave Argentina less flexibility with its monetary policy. This prevented Argentina from "monetizing" its growing debt by printing money and paying in the form of higher inflation.

During this period, significant deficits existed because of huge pension systems, large grants to regional governments, corruption, and an inefficient, subsidized private sector.[8] Increasing imports and low exports created a critical balance of payment problem.[9] For example, in 1997, exports accounted for less than 9 percent of GDP.[10]

By 1997, Argentina's foreign debt was over $100 billion dollars.[11] The economy, mired in a recession, began to unravel as wave after wave of debt came due. Debt eventually became so great that Argentina could no longer borrow except at very high interest rates. Eventually, even multilateral lending institutions such as the IMF refused further credit. A default became inevitable, as Argentina could no longer borrow to service its existing debt.[12] When the crisis hit, Argentina closed banks and defaulted on its debt. Restrictions on bank withdrawals, the drop in the currency value, and a ruined economy sparked riots and social

5. Tracinski, *supra* note 2.

6. Krugman, *supra* note 4.

7. *Id.*

8. *Economic Conditions*, POLITICAL RISK SERVICES, Dec. 1, 1996, LEXIS, News Group File.

9. *Economic Conditions*, POLITICAL RISK SERVICES, Dec. 1, 1997, LEXIS, News Group File.

10. *Id.*

11. *Economic Conditions 93*, *supra* note 1.

12. *IMF to Blame for Argentina's Crisis*, IPR STRATEGIC BUSINESS INFORMATION DATABASE, Dec. 31, 2001, LEXIS, News Group File.

unrest.[13]

Missing from this brief summary is the relationship of IMF policies to Argentina's crisis. Argentina had been borrowing for almost a decade to support its currency board and budget deficit. If the economy had emerged from recession during that period, the IMF's Argentine program might have been deemed a success, and the IMF would certainly have taken a large part of the credit. Argentina's economy, however, remained stalled in recession. Part of this comment's goal is to analyze whether the IMF's policies, or the so-called "Washington Consensus," may be partly to blame for prolonging the recession, eventually leading to default and economic collapse.

Criticism of IMF activity in Argentina can be divided into four camps. Some critics believe the IMF was too strict in its lending conditions to Argentina.[14] Other critics hold that the IMF was too lenient and let Argentina continually ignore the loan conditions.[15] Another view is that the crisis was self-inflicted through corruption and profligate spending.[16] Finally, a fourth view holds that the IMF cut off funds just when Argentina was finally about to turn around the economy.[17]

These views over-simplify a complex situation and allow the IMF to use the disparity of criticism as a shield, claiming it is unjustifiably criticized whatever it does.[18] In addition, the criticism over the IMF's Argentina program is relatively muted in comparison to the level of disapproval expressed by leading economists, such as Paul Krugman, Jeffrey Sachs, and Joseph Stiglitz, regarding the IMF's actions in the 1998 Asian and Russian crises. The goal of this comment is to examine the IMF's relationship with Argentina over the course of a decade. The following questions will provide the framework for this comment: Did the IMF help cause the crisis? What can the IMF do to make another crisis less likely? What can the IMF do to make sure that if another crisis occurs it will have less devastating effects? What are the consequences of the policies the IMF puts into place and the conditions it imposes? Has the IMF learned from its mistakes? Is there

13. *IMF Team Reaches Argentina, Mass Protests Planned*, AGENCE FRANCE PRESSE, May 30, 2000, LEXIS, News Group File.

14. Steven Pearlstein, *For IMF, Argentina was an Unsolvable Puzzle*, WASHINGTON POST, Jan. 3, 2002.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

a demonstrable connection between IMF policies and economic growth? Were IMF policies appropriate for Argentina?

It is the conclusion of this comment that the conditions imposed by the IMF on Argentina did not address the causes of the crisis, but, similar to its programs in past crisis countries, served to encourage the nation to adopt the Washington Consensus, even when it may have been inappropriate to do so. This conclusion is itself over-simplistic and will have to be qualified in many respects. This comment will interweave the story of the relationship between Argentina and the IMF with evidence demonstrating the IMF's inappropriate action in Argentina.

II. THE IMF AND ARGENTINA

A. *A Growing Crisis*

As far back as 1991, Argentina began to follow the IMF formula for economic stabilization and development, almost indistinguishable from the so-called "Washington Consensus."[19] This advice typically consists of reducing budget and balance of payment deficits, raising interest rates, reducing inflation, privatizing state assets, and reducing trade barriers and regulation on capital flows in and out of the country. Few criticized the IMF's advice to Argentina in the early 1990s. Inflation was brought under control and the IMF backed program helped combat fiscal profligacy, which was Argentina's most serious economic problem at that time.[20] After years of inflation rising near 2000% per year and a budget deficit at 23% of GDP, the decision to cut state spending, reduce inflation, and privatize state industries seemed the best advice.[21]

By 1995, however, Argentina's economy was experiencing a recession. The cash strapped nation had to obtain $11 billion in financing, including $2.4 billion from the IMF, due to budget deficits, a recession, and capital flight as the result of reaction to the Mexican crisis.[22] IMF decisions began to have a substantial influence on Argentina's economy, stock market, and foreign investment plan. In May of 1995, Argentina's government, fearing an adverse market reaction, attempted to deny a report that it would

---

19. *Argentina*, BBC, Jul. 9, 1991, LEXIS, News Group File.
20. *Economic Conditions 93*, *supra* note 1.
21. *Id.*
22. *Minister of Economy Announces Financing Package*, BBC, Mar. 15, 1995, LEXIS, News Group File.

have to renegotiate IMF loan conditions.[23] A few months later, the government initiated renegotiations resulting in a huge fall in the Argentine stock market.[24] A recurrent pattern would develop over the next six years, where the government would deny the gravity of a situation only to capitulate and lose face shortly thereafter.

Although Argentina was entering a recession, the IMF's dogmatic, fiscally oriented conditions remained the same as provided in the early 1990s. It continued to insist on a fiscal surplus and austerity measures, despite a growing recession. This resulted in furthering an economic slowdown that depressed tax revenue, making it impossible for Argentina to reach the IMF's fiscal targets.[25] However, because Argentina continued to liberalize its economy through privatization, deregulation, and attempts at fiscal discipline, the IMF continued its support.[26]

In the 1990s, the IMF rarely varied its advice from nation to nation, regardless of the specifics of each crisis. Why were IMF conditions largely the same for Argentina, Mexico, Russia, and Asia, unique economies with different types of crises? The IMF's "success" in the Mexican crisis, which most observers agree was a fiscal crisis, is one possible explanation for the IMF's one-size-fits-all program.[27] This may have led the IMF to treat Argentina in 1995 and the Asian crisis in 1998 in a similar manner. In essence, the IMF's unwavering faith in its prescription kept it from correctly diagnosing the problem in Asia in 1998, which was a regulatory and banking crisis, not a fiscal crisis.[28] Similarly, the primary problem with Argentina's economy in 1995 was the recession, not fiscal profligacy.

The IMF's program of raising interest rates, cutting spending, raising taxes and imposing other austerity measures had some success in Mexico in 1994. The IMF began to apply the formula across the board.[29] The IMF's advice worsened the recession in Asia that resulted from the crisis and created a panic as well.[30] Asia essentially had a liquidity problem due to overextended and

---

23. *Finance Secretary Denies Reports of Waiver*, BBC, May 24, 1995, LEXIS, News Group File.

24. *Education*, BBC, Aug. 29, 1995, LEXIS, News Group File.

25. *Argentina: Country Update*, Oct. 27, 1995, LEXIS, News Group File.

26. *Id.*

27. *Frontline: The Crash: Interview with Paul Krugman, at* http://www.pkarchive.org/crises/crash.html [hereinafter *Krugman*]. Many doubt whether the Mexican program was really a "success." *See infra* text accompanying note 35.

28. *Id.*

29. *Id.*

30. *Id.*

improperly regulated banks, not a fiscal problem.[31] Fiscal austerity had worked in Mexico with its loose monetary policies and huge public debts.[32] After it failed in Thailand, the IMF kept imposing the same advice on the rest of Asia as the crisis spread.[33] After the Asian crisis, the IMF should have learned something, but it prescribed the same policies for Brazil. The IMF conditioned loans to Brazil on raising interest rates, cutting the budget, and suffering through the recession.[34]

By the end of 1995, Argentina was so heavily dependent on IMF loans and advice that not adhering to IMF polices threatened to create an investor backlash.[35] Regardless of the efficacy of the

31. Joseph Stiglitz, *The Insider - What I Learned at the World Economic Crisis*, THE NEW REPUBLIC, Apr. 17, 2000, http://pkarchive.org/others/stiglitz.html.

32. *Krugman*, *supra* note 27.

33. Stiglitz, *supra* note 31.

34. *Krugman*, *supra* note 27.

35. *See Frontline: The Crash: Interview with Jeffrey D. Sachs*, *at* http://www.pbs.org/wgbh/pages/ frontline/shows/crash/interview/sachs.html (last visited Nov. 5, 2002) [hereinafter *Frontline: The Crash*]. The fact that by the mid-1990s investors viewed IMF statements as important signals of Argentina's economic well being meant that the IMF should have been extremely careful as to the remarks it made. The IMF has been criticized for making announcements and taking drastic measures that caused a panic in Asia, making the crisis worse than it otherwise would have been. At times, the IMF also seemed heedless of creating a panic in Argentina. The IMF issued a forecast for the economy that warned of a speculative attack if the government did not institute further austerity measures. Similar types of statements helped create the Asian crash.

When the IMF intervened in Mexico, instead of reassuring investors by providing loans and assurance that problems were going to be corrected, the seriousness and austerity of the measures triggered the large part of the panic. Mexico quickly paid the IMF back, but money to accomplish this was simply borrowed from capital markets, placing the debt burden on the Mexican people. Bulgaria, Mexico, and Argentina in 1995, resembled Asia in that the IMF called for bank closures that caused panic and capital flight.

When the IMF takes drastic actions, investors are prone to think something must be critically wrong. After Thailand, the IMF intervened in such a dramatic way in Indonesia and Korea by ordering banks to close that there was a general bank run causing the banking system to implode and dragging the rest of the economy down with it. Most economists insist the fundamentals in Asia were good. Intervening with such dire announcements, when coupled with the typical conditions of high interest rates, bank closures, and budget cuts, only enhances investor fear that the economy is going into a contraction. The way the IMF goes about setting up a program only aggravates the crisis by asking for a wholesale restructuring of the economy-monetary, trade, and fiscal policy. This combined with social costs, such as unemployment, overwhelmed the countries.

See also Paul Krugman, Will Asia Bounce Back? Speech for Credit Suisse First Boston, Hong Kong (March 1998), *at* http://web.mit.edu/krugman/www/suisse.html. While Krugman agrees fiscal problems in Asia were not serious and an austerity plan of the type the IMF imposed was not appropriate, he does not agree with Sach's panic theory. Krugman explains that the IMF cannot act as a "no questions asked" lender of last resort as Sachs would have it. First, the IMF, even when coupled with funds

IMF's advice, the government could not ignore it without drawing the attention of international markets, which had begun to view the relationship between Argentina and the IMF as an indicator of whether Argentina's economy was healthy.[36] Throughout 1996, Argentina continued to follow the IMF's advice, but was unable to meet most of the IMF's conditional fiscal and tax targets due to recession.[37]

---

from the United States may not have enough money. Indonesia and Korea may have quickly run through their credit line with any amount the IMF could actually afford. Second, the crisis was not solely caused by a panic. A lender of last resort should lend to illiquid banks, not insolvent ones, as was true of a number of Asian banks.

See also Jeffery Sachs, *The IMF and the Asian Flu*, 9 THE AMERICAN PROSPECT, March 1 – April 1, 1998, *available at* http://www.prospect.org/print/V9/37/sachs-j.html [hereinafter *The IMF and the Asian Flu*]. Panic can destroy an economy when a high proportion of debt is short-term, so-called "hot money." In the 1990s, many nations, on the advice of the IMF, opened up to international capital flows without a proper regulatory environment, becoming susceptible to waves of euphoria or panic. If foreign banks and other lenders loan large amounts of money to domestic banks short term, which is then invested in long-term projects, the economy can be ruined by a panic if banks decide to withdraw money out of the country. Because of pressure on developing nations from the Unites States Treasury and the IMF to open markets too quickly before adequate regulations were in place, short-term capital invested in countries became volatile. "Hot money" fueled the Thai real estate boom that helped cause the first Asian crash. The nations brought down in the Asian crisis had a total short-term debt of $175 billion. As the flow of private capital increases due to globalization, more crises will occur without regulation. Volatility in international capital played a big role in the Great Depression as it does with recent global crises.

Argentina set limits on bank withdrawals and converted dollar debt to pesos as the crisis unfolded to stem the hemorrhage of capital. Nevertheless, Argentina lost as much as $25 billion in loans called in and taken off shore in the months preceding the crisis. Argentina also lost a good deal to capital flight in 1994 and 1995. The IMF could make it a condition for loans to have some regulations on the percentage of capital that is short-term or even lobby for international regulations on capital movement.

See also Paul Krugman, *Start Taking Prozac*, World Economy Laboratory Columns Archive, May 1998, *at* http://www.imfsite.org/reform/krugman.html; Interview by Lucy Komisar, *Joseph Stiglitz: The Progressive Interview*, 64 THE PROGRESSIVE, June 1, 2000, 2000 WL 12369796. The world has moved from a national to a global financial architecture without creating the corresponding global version of national regulation. Insisting that countries open their markets to global markets before adequate regulations are in place may create an economic disaster. Some claim that all that is needed is greater transparency in developed countries. However, investors had much of the key information needed to predict the crises. For example, it was apparent to investors that the Korean firms had high debt to equity ratios. Great Britain and Scandinavia, which probably have the highest level of transparency in the world, have also had crises in recent times.

36. *Five-Year Forecasts of International Economic Problems*, POLITICAL RISK SERVICES, Dec. 1, 1995, LEXIS, News Group File.

37. *See IMF Approves 1.04 Billion Dollar Stand-by Loan to Argentina*, AGENCE FRANCE PRESSE, Apr. 13, 1996, LEXIS, News Group File; *IMF Approves Waiver, New Targets for Argentina*, AGENCE FRANCE PRESSE, Oct. 31, 1996, LEXIS, News Group File.

By the end of 1996, there were rising tensions between the government and Argentine interest groups, which held that the economic policy insisted on by the IMF was doing permanent damage to the economy.[38] Austerity measures risked plunging Argentina's economy, already hurt by the 1994 Mexican crisis and 1995 recession, deeper into recession.[39] Business leaders, economists, and trade union leaders protested President Carlos Menem's introduction of tax increases and spending reductions.[40] Instead of attempting to revive the economy and pay off foreign debt with the higher resultant tax revenues and export income, Menem continued cutting the budget and raising taxes and interest rates. Although growth would slow and unemployment increase, the IMF insisted the austerity plan would help Argentina survive coming amortization and interest payments, which would reach a new high in 1997.[41] IMF loans continued to arrive to service the $101 billion 1997 foreign debt.[42]

By 1998, domestic criticism of the IMF's extended role in Argentina was overshadowed by the nation's dependence on IMF credit to support the currency board, as well as its addiction to borrowing from foreign lenders.[43] Furthermore, the international lending community itself believed the fate of the economy was inexorably linked to its relationship with the IMF.[44]

The fact that the beleaguered nation was entering its seventh year of being unable to meet IMF conditions might have been a signal to IMF officials. The IMF could have been accused of being too lenient. The government seemed unable or unwilling to fully comply with the IMF's conditions, yet loans continued to arrive. Perhaps the IMF, like many banks, was simply unable to abandon a failed project and preferred to keep throwing money at it in expectation of an eventual turnaround. The budget deficit was $8 billion, or 60% over IMF aims.[45] The government was, in a sense, sitting between two chairs, austerity and stimulus, without gar-

38. *Economic Conditions 93*, *supra* note 1.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. Arthur MacEwan, *Economic Debacle in Argentina: The IMF Strikes Again*, FOREIGN POLICY IN FOCUS, Jan. 2, 2002, *available at* http://www.fpif.org/commentary/2002/0201argentina_body.html.

44. *More Belt Tightening Necessary in Argentina*, AGENCE FRANCE PRESSE, Mar. 15, 2001, LEXIS, News Group File.

45. *IMF Official Paints "Disturbing" Picture for Argentine Economy*, BBC, Apr. 14, 1998, LEXIS, News Group File [hereinafter *IMF Official*].

nering the benefits of either. The economy continued to drift in recession and the government supported its deficits and debt servicing with further international borrowing. The IMF may have been able to use its loans and influence on the international markets to apply more pressure than it did on the Argentine government. Alternatively, the IMF may have been wrong because its programs were too austere to support Argentina socially and politically, especially in the midst of a recession.

B. The Currency Board

Argentina's trade deficit was growing largely due to an overvalued Peso. A pegged currency has the disadvantage of placing one nation at the mercy of another nation's monetary policy and limits a government's ability to exercise expansionist monetary policy during a recession. The Peso was creeping up in value throughout the 1990s, on the back of the strengthening dollar, which hurt exports by making them more expensive.[46] On the other hand, the cost of borrowing is less expensive because lenders see Pesos as readily convertible. This may accelerate internal development and hold inflation in check. Imports are cheaper, which should force domestic industry to become more competitive to match the increasing buying power and standard of living accessible to consumers through the consumption of imported products.

It may have been better to devalue earlier and gradually, and therefore less painfully. Argentina's case could be compared to that of Russia, which benefited enormously from devaluation.[47] Only after devaluation did the Russian economy improve because of increased exports. Nevertheless, the IMF repeatedly warned Russia against devaluation up until the crash occurred.[48] Many in the Russian government wanted devaluation, but the IMF convinced them otherwise.[49] Renowned economist Paul Krugman believes that, for Argentina, devaluation and a conversion of Dollar debts into Pesos was necessary long before the 2001-2002 crisis. Argentina only prolonged its agony.[50] The currency board had been instituted to provide stability, but was not an end in itself. The overvaluation was depressing the economy, leading to a

46. MacEwan, *supra* note 43.
47. *Frontline: The Crash*, *supra* note 35.
48. *Id.*
49. *Id.*
50. Paul Krugman, *Crying with Argentina*, N.Y. TIMES, Jan. 1, 2002, at A21.

higher real interest rate and depressed exports.[51] In 1998, however, the IMF insisted the currency board had "served Argentina well, and continues to be an adequate framework for stable growth."[52] As late as 2001, the IMF continued to praise the dollar peg.[53]

Argentina's fiscal picture was not hopeless. Its budget deficit ranged from 1 to 3% of GDP, and its government debt was only half of GDP.[54] This is better than many European countries.[55] The real problem in Argentina was not fiscal but economic. The peg, designed to protect against inflation, "precludes any actions that countries design to take to fight deflation, such as cutting interest rates or letting the currency depreciate."[56] Krugman notes:

> Argentina has gone through wave after wave of fiscal austerity, each time with the promise that the latest round of wage or job cuts would restore confidence and produce economic recovery. However, austerity did not bring recovery. On the contrary, it worsened the recession, increased social tension and further reduced confidence.[57]

Since spring 2000, economists at the IMF and in the United States have been urging Argentina to preserve its peg and default on its debt instead.[58] The IMF seems to provide the same fiscal advice to everyone regardless of the type of crisis. Advanced countries often devalue their currencies and never default on debt. Yet, the IMF preferred some debt default to devaluation,[59] even though Argentina's debt was only half of GDP, which is not excessive by modern standards. Default, however, would not let Argentina cut interest rates, make goods more competitive, or end the need for draconian fiscal austerity. Default would, in fact, do nothing to end the crisis.[60]

The IMF now claims it opposed the currency board despite IMF statements throughout the 1990's that seem to prove the con-

---

51. Krugman, *supra* note 4.
52. *IMF Concludes Article IV Consultation with Argentina*, Mar. 11, 1999, http://www.imf.org/external/np/sec/pn/1999/pn9921.htm.
53. *IMF Praises Currency Peg*, AGENCE FRANCE PRESSE, Jan. 26, 2001, LEXIS, News Group File.
54. Paul Krugman, *A Cross of Dollars*, N.Y. TIMES, Nov. 7, 2001, at A23.
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.*

trary.[61] In addition, the IMF clearly supported overvalued currencies in Russia and Brazil, although they led to tens of billions in loans to fight off an inevitable devaluation. In retrospect, Russia and Brazil seem much better off having devalued their currencies, and the much-dreaded hyperinflation never materialized. Also, maintaining a currency peg, even if the currency is slightly overvalued as a result, would seem to be justified according to IMF philosophy. After all, interest rates are raised to attract foreign investors and much of the program is aimed at increasing investor confidence. The currency peg initially increased investor confidence by making it more likely that contracts in foreign currency would be honored, even in an economic slowdown.

Many IMF policy decisions are made to promote stable exchange rates.[62] But these often wreak havoc, as in the case of Argentina. If the exchange rate floats freely there is no need for loans,[63] and the balance of payments will be self-equilibrating.[64] Increased interest rates, monetary contractions, and tax increases are often imposed with the view of keeping the exchange rate stable.[65] But it is questionable whether it is worth the effort. People do not eat exchange rates, and, in the cases of Russia and Brazil, countries are often much better off once the currency is allowed to float. Much of the IMF's program would be unnecessary if a floating exchange rate were adopted.

C. *Issues of Social Equity*

1998 also brought increasing criticism that the IMF was apathetic to the costs of its programs on the public.[66] Argentine elections and the growing need for social programs to offset the effects of recession on the poor were beginning to clash with the IMF's old and precise formula. That formula was: raise interest rates to slow down domestic consumption and increase tax pressures to shrink domestic demand, which in turn increases the proportion of exports to imports and results in a balance of payments.[67] The IMF battled the government's attempts to institute labor reform,

---

61. Joseph Stiglitz, *Lessons from Argentina's Debacle*, STRAITS TIMES, Jan. 10, 2002, http://www.globalpolicy.org/socecon/bwi-wto/imf/2002/0110stiglitz.htm.
62. Lawrence McQuillian, *The Case against the IMF*, ESSAYS IN PUBLIC POLICY, 1998, *at* http://www-hoover.stanford.edu/publications/epp/98/98b.html.
63. *Id.*
64. *Id.*
65. *Id.*
66. *IMF Official*, *supra* note 45.
67. *Id.*

raise teachers' salaries, and improve deteriorating road conditions.[68] Concerns about rising unemployment were dismissed when the Argentine Labor Minister went to Washington in search of relief from pending IMF conditions, only to return having had to accept IMF policies.[69] IMF programs are "voluntary," but as economist Jeffery Sachs notes,

> [w]hen the United States informs a poor developing country that it must agree with the IMF or else lose access to foreign aid, the goodwill of major governments, chances for debt restructuring, and the confidence of the private markets, which are encouraged by the G-7 to use IMF agreements as the focal points for their own bargaining, the notion of voluntarism is a bit stretched.[70]

Policies will not be sustainable in the long term if they do not deal with issues of social equity.

Arguably, there must be something wrong with a system that passes such high costs onto people that have not been speculating on the international markets. In 1998, many saw the IMF's bailouts as protecting wealthy investors, whose risky loans were paid by the governments with IMF loan money, at the expense of the poor, who ultimately bore the brunt of the austerity programs installed to pay for those loans.[71] In Thailand, Indonesia, and South Korea, health care, education, and environmental spending were all drastically cut as part of the IMF austerity program.[72] Unemployment and the poverty rate soared and remained long after these nations were "officially out of the recession."[73] The social effects of IMF programs in Thailand, Indonesia, and Korea are similar to those in Argentina. Most countries with IMF programs seem to experience similar deterioration, at least in the short term. The few bright spots in the reduction of poverty have been in China, India, and Botswana, nations that never had IMF programs. It is essential that the IMF have governing boards with greater representation among developing nations.[74] At pre-

68. *Id.*

69. *IMF Sets New Deadline for Modernizing Labor Laws*, BBC, July 28, 1998, LEXIS, News Group File.

70. *The IMF and the Asian Flu*, *supra* note 35.

71. *Stiglitz*, *supra* note 35.

72. Jacques-chai Chomthongdi, *The IMF's Asian Legacy*, FOCUS ON TRADE, Sept. 2000, http://www.globalpolicy.org/socecon/bwi-wto/imf/2000/asiafc.htm.

73. *Id.*

74. David Hage, *Joseph Stiglitz- A Dangerous Man, A World Bank Insider that Defected*, MINNEAPOLIS STAR-TRIBUNE, Oct. 11, 2000, *available at* http://www.commondreams.org/views/101100-101.htm.

sent, the United States dominates the IMF decision-making process, with Japan and Europe also weighing in.[75]

If the IMF holds increasing investor confidence in the borrowing country to be an important goal of its programs, how do riots, unemployment, declining wages, and cuts in health and education spending achieve this goal? The purpose of contractionary fiscal policies is partly to build investor confidence. If these policies involve killing social programs and cutting wages that lead to riots and unemployment, what sort of confidence is built? Imagine a potential investor sitting down to his morning coffee and reading about riots in Indonesia and mass strikes by government workers. Will he rush out to invest? The IMF could easily predict a reaction of social unrest if the country is already deep in a recession. Often, as a result of "market based pricing," riots and social unrest occur. Social unrest was easily foreseeable whether it was the Indonesian riots after the IMF program eliminated food and fuel subsides for the poor, the 2000 Bolivian riots over water prices, unrest in Ecuador caused by the rise in cooking gas prices at the bequest of the World Bank,[76] or the Argentine riots in reaction to bank withdrawal limits, cuts in government salaries, new taxes and the expected currency collapse. In fact, the IMF actually predicts these riots.[77] For example, in 2000, reports from the Country Assistance Strategy for Ecuador stated that the IMF expects its program to spark "social unrest."[78]

D. *Moral Hazard*

Many investors believed the Peso would remain stable because an IMF bailout would occur if necessary. For this reason, investors may have been more likely to enter into contracts than they otherwise would have been. In a contract where a foreign creditor doubts the ability of the borrower to repay in hard currency, moral hazard is created when the creditor realizes that IMF loans will support the Peso and allow it to maintain an artificially high value. The creditor will assume the borrower can convert his pesos to dollars and make the loan when he otherwise would not. The balance of risk versus payoff does not determine

---

75. *Id.*

76. Gregory Palast, *The IMF's Four Steps to Damnation*, THE OBSERVER, Apr. 29, 2001, *available at* http://www.globalpolicy.org/socecon/bwi-wto/imf/2001/pala0429.htm.

77. *Id.*

78. *Id.*

whether the loan should be made, but the confidence that the IMF will come to the rescue regardless does. Moral hazard occurs when the IMF's promise of a subsidized bailout reduces the cost of fiscal irresponsibility.

The risk of moral hazard connected to IMF loans may have increased with the 1994 Mexican bailout. The IMF bailed out Mexico so it could pay off foreign banks that were making risky loans with interest rates as high as 20% per annum. The banks were not required to bear the risk they had assumed. A sharing of the losses by banks and the governments may have been a better option now that we realize that the Mexican bailout contributed to the Asian crisis.[79] Once banks saw that the IMF would bail them out, they began to make risky investments in Asia.[80] International banks now felt they had a safety net.[81] Although the Mexican government quickly repaid the loans, they did so by borrowing from capital markets at higher interest rates.

In the midst of a recession in the mid 1990s, the Russian government had gone on a borrowing spree fueled by short-term bonds, called GKOs, with enormous interest rates.[82] Moral hazard permitted Russia to finance huge unbalanced budgets with interest rates as high as 100%.[83] Encouraged by the Mexican bailout, foreign lenders felt Russia was even more important than Mexico and so would be bailed out in any case.[84] Interest rates continued to rise and the government kept paying foreign investors, which were making unprecedented returns on their capital.[85] The IMF supplied the money to pay off the investors. Eventually there was a crash and the Russian people were saddled with enormous debt, while, as in Asia, investors escaped unharmed.[86]

While creditors in Asia did not receive explicit guarantees from the government, press reports do suggest that those who pro-

---

79. Allan Meltzer, *What's wrong with the IMF*, THE INDEPENDENT REVIEW, v. IV, n.2, Fall 1999, 201-215, *available at* http://www.imfsite.org/reform/meltzer.html.

80. *Id.*; *See also* McQuillian, *supra* note 62. Foreign bank debt accounted for 58 of the 76 billion in capital inflow to Asia the year after the 1995 bailout. Many economists believe this was partly due to the bailout in Mexico. By 1997, foreign bank debt was 25% of the GDP of South Korea, 35% of the GDP of Indonesia and 45% of the GDP of Thailand. It is important to remember that the IMF bailed out foreign institutions that made bad loans to these countries; it did not bail out the citizens of these countries who will have to pay for the bailout.

81. Meltzer, *supra* note 79 at 207.

82. Sachs, *supra* note 35.

83. Meltzer, *supra* note 79, at 209.

84. *Id.*

85. Sachs, *supra* note 35.

86. *Frontline: The Crash*, *supra* note 35.

vided funds to Thai finance companies and South Korean banks, many of which were foreign lenders, believed they would be protected from risk.[87] This impression was reinforced by the political connections of the owners of such institutions.[88] Depositors in all Thai finance companies were protected.[89] Bank debt in Korea was largely nationalized, the IMF gradually paid back, and the populace bore the burden in the form of higher taxes and spending cuts in education, health, and other government programs.[90] In 1994, the IMF bailout of investors in Mexico "effectively privatized investor profits and socialized investor losses."[91] "By removing the risk of default, the IMF encouraged riskier global investment that fueled the East Asia crisis that erupted two years later."[92]

Asian governments were stuck with debt while foreign creditors making risky investments went unscathed.[93] After the Asian crisis, George Soros remarked that the IMF responded by saving many economies from default, but in the process, it effectively "bailed out foreign investors who had speculated in their unsustainable growth."[94] In the end, the people were left to absorb the costs. Changes in IMF policies have forced investors to share more of the risk but this has only resulted in higher lending costs.[95]

By removing the risk of default, the IMF encouraged riskier global investments.[96] When a bailout occurred in Mexico and Asia, and again in Russia and Brazil, was it not reasonable for foreign investors in Argentina to expect a bailout as well? Argentina was capable of borrowing more and more, at higher and higher interest rates, fueled by less risk, because of an expected bailout.

There is no evidence that moral hazard operated on the same level in Argentina as in Asia and Russia, partly because Argentina is not a nuclear or economic power. There was always some doubt as to how big a bailout would occur. Ultimately, during the

87. Paul Krugman, *What happened to Asia?*, January 1998, http://web.mit.edu/krugman/www/DISINTER.html.

88. *Id.*

89. *Id.*

90. *Id.*

91. McQuillian, *supra* note 62.

92. *Id.*

93. *Frontline: The Crash*, *supra* note 35.

94. Michael Lelyveld, *Soros, Sachs Criticize IMF's Policies*, RADIO FREE EUROPE, Nov 17, 2000, *available at* http://www.rferl.org/nca/features/2000/11/ 17112000140 141.asp.

95. *Id.*

96. McQuillian, *supra* note 62.

recent crisis, the IMF cut Argentina off and refused to offer loans equivalent to those provided to Asia and Russia. Argentina's IMF loans currently total 21.7 billion.[97] In July 1998, Russia received 22 billion from the IMF in just one installment.[98] Still, moral hazard may have played some part in the crisis. For example, moral hazard may not only influence investors, but government officials as well.[99] It is sufficient for the existence of subsidized loans from the IMF to modify a finance minister's evaluations of the costs he faces.[100] Lending may delay reform by permitting governments to continue inappropriate practices.[101] In Argentina, the possibility of a bailout may have caused Finance Minister Cavallo to keep the currency peg longer than he should have because he could use IMF loans to defend it. After all, the peg was essential to controlling inflation and maintaining the Argentine standard of living. Furthermore, although new rules are imposing higher interest rates on borrowers, IMF rates are well below market rates.[102] For example, Korea borrowed from the IMF in 1998 at 4.5% at the same time it was issuing bonds at 14.5%.[103]

Foreign policy introduces further elements of moral hazard. Many investors in 1998 admitted to planning to put on large Brazilian or Russian positions because they felt that the IMF would come in with a bailout for political reasons.[104] In 1998 and 1999, the IMF, under pressure from the U.S. Treasury, expressed strong support for Argentine bonds.[105] In part, this was because Argentina was a staunch supporter of the United States and poster child for the Washington Consensus.[106]

E. Protests and Further Decline

In 1999, although the IMF was preparing to increase its level of aid to the nation, Argentina failed to meet IMF targets prima-

97. *IMF Offers Argentina 8 Billion Dollars*, AGENCE FRANCE PRESSE, Aug. 22, 2001, LEXIS, News Group File.

98. John Laughland, *The IMF Deserves no Credit*, http://www.bhhrg.org/press-articles/press1998/imf-eur.htm (last visited November 26, 2002).

99. Meltzer, *supra* note 79, at 209.

100. *Id.* at 212.

101. *Id.*

102. McQuillian, *supra* note 62.

103. *Id.*

104. Charles Calomiris, *When will Economics Guide IMF and World Bank Reforms?*, Vol. 20, No. 1, CATO JOURNAL 85, 89 (Spring/Summer 2000).

105. *Id.*

106. *Id.*

rily due to recession.[107] The ineluctable cycle of missed targets and further loans fueled criticism of the IMF's policies. Fiscal deficit overshot targets by $3 billion in the context of minimal GDP growth.[108]

In 2000, the IMF approved a $7.4 billion stand-by loan in exchange for a commitment to keep the 2000 budget deficit below $4.7 billion and demanded Argentina phase out its fiscal deficit by 2003.[109] Street protests against IMF visits began and would continue intermittently until the current crisis. In order to obtain IMF loan aid to service the now $115 billion debt, President Fernando de la Rua announced an austerity plan approved by the IMF that included steep tax hikes and cuts in social spending.[110] A large range of groups and institutions, including the Roman Catholic Church, held the IMF largely responsible for the nation's continued economic malaise.[111] With one-third of the population living below the poverty line and 14% unemployment, mounting social unrest led to one death and several injuries during the anti-IMF riots.[112]

In October, almost exactly a year before the beginning of Argentina's economic meltdown, the IMF had praise for Argentina's economy, which was in "good economic condition to resume sustainable growth."[113] The praise was understandable, as the government had agreed to follow the IMF formula at any cost. In November, the government met with provincial governors to reach spending cut agreements prior to IMF agreement to send a team to discuss further lending arrangements. While Wall Street was pleased, government workers joined the poor in erecting roadblocks to protest the still rising unemployment rate and potential further IMF austerity measures.[114] By the end of 2000, the IMF was contemplating another fresh loan package worth $15

107. See *Argentina to Negotiate Physical Debt Margin with IMF*, BBC, Mar. 23, 1999, LEXIS, News Group File; *Argentina Asks IMF to Raise Deficit Targets*, AGENCE FRANCE PRESSE, May 18, 1999, LEXIS, News Group File.

108. *Argentina likely not to Meet IMF Targets*, BBC, Mar. 3, 1999, LEXIS, News Group File.

109. *Agreement with IMF Announced*, BBC, Feb. 5, 2000, LEXIS, News Group File.

110. *IMF Team Reaches Argentina, Mass Protests Planned*, AGENCE FRANCE PRESSE, May 30, 2000, LEXIS, News Group File.

111. *Id.*

112. *Id.*

113. *IMF says Argentine Growth Weaker than Expected*, AGENCE FRANCE PRESSE, Oct. 3, 2000, LEXIS, News Group File.

114. *IMF Delays Argentina Trip Amid Row Between Federal Government and Provinces*, AGENCE FRANCE PRESSE, Nov. 17, 2000, LEXIS, News Group File.

billion.[115]

F. IMF Policy and the 2000-2001 Recession

To achieve the IMF program of reducing budget and balance of payment deficits, reducing inflation, privatizing state assets, increasing investor confidence, and reducing trade barriers and regulation on capital flows in and out of the country, the IMF imposes conditions on borrowing governments that frequently involve raising taxes and interest rates and cutting government bureaucracy and social spending, which may lead to higher unemployment rates or reduced government salaries. A recession, however, may call for tax cuts, government spending to stimulate the economy, cuts in interest rates, and deficit spending. Why should Argentina pursue an austerity program when no developing nation would embark on such a program during a recession?

Adherence to the Washington Consensus means IMF programs may be imposed on borrowing nations in a manner that ignores the particular social, political, and economic circumstances prevailing at that time. Too often, the IMF seems to employ a double standard when issuing advice to developing countries.[116] For example, imagine the United States, in the midst of a recession, insisting on tight fiscal and monetary policy such as balancing the budget, raising interest rates, increasing taxes, reducing inflation, and slowing the economy.[117] The United States in past recessions has cut taxes, lowered interest rates, and gone into deficit spending to stimulate the economy.

The IMF conditioned money in 2000-2001 in the midst of a recession on a zero-deficit policy.[118] The United States itself does not put emphasis on balancing a budget in a recession. In fact, Argentina has run modest budget deficits, much smaller than our own deficits during past recessions.[119] Developing countries, how-

115. *World Bank Approves $303 Million Loan for Argentine Province*, AGENCE FRANCE PRESSE, Nov. 22, 2000, LEXIS, News Group File.

116. Komisar, *supra* note 35.

117. *Id.*

118. *IMF, Argentina Negotiations Enter Sixth Day*, AGENCE FRANCE PRESSE, Aug. 15, 2001, LEXIS, News Group File.

119. Mark Weisbrot, *Argentina's Crisis, IMF Fingerprints*, WASHINGTON POST, Dec. 25, 2001, at A33; *See also* Arthur MacEwan, *Economic Debacle in Argentina: The IMF Strikes Again*, FOREIGN POLICY IN FOCUS, Jan. 2, 2002, http://www.fpif.org/commentary/2002/0201argentina_body.html. Often investors see the budget cuts themselves as a sign of the country's worsening crisis. It does not restore investor confidence. In July, after the IMF prescribed budget cuts Argentina could only sell bonds at 14% as opposed to 9% in mid-June.

ever, are often told that they cannot implement the type of programs developed countries do when they face similar circumstances.[120] Are developing countries too incompetent to stray from any policy but the most conservative? The IMF seems to want developing nations to live in a Pre-Keynesian world, while the United States, Europe, and Japan enjoy the fruits of Keynesian knowledge. The United States has declined to introduce a balanced budget amendment into its Constitution because it would "eliminate the ability to use fiscal policy as an anti-cyclical device in a recession."[121] In Argentina, the IMF seems to have ignored the danger of imposing austerity packages on a country in the midst of a prolonged recession. Would expansionist policies not have been more appropriate? If there was ever a time for the IMF to break from its ideology, the 2000-2001 recession may have provided a window of opportunity to react to the specific needs of Argentina's economy instead of following its formula, which in the midst of a recession was threatening to strike the final blow to the economy.

Perhaps the IMF's lack of country specific teams limits their ability to do this. The IMF's record in Argentina indicates that it did not waver, at least publicly, in ten years of prescribed austerity, which, with some exceptions, was never really achieved. The global slowdown in 2000-2001 following the 1998 crises created an emergency economic situation in Argentina that may have called for an economic stimulus instead of contraction. Nobel economic laureate Joseph Stiglitz noted, "fiscal austerity was supposed to restore confidence, but any economist would have predicted that contractionary policies would incite slow-down, and that budget targets would not be met."[122] Argentina was already deep in debt, however, so the developed country analogy may not be entirely appropriate. Still, the recession may have been a higher priority than the Argentine debt, which was only 50% of GDP. Austerity may have been the final kiss of death for Argentina.

With the Argentine population already suffering a deep recession, the austerity package led to social chaos by requiring further cuts in social spending. First, this chaos further undermined investor confidence. Second, growing opposition to pursuing austerity over expansionist policy led to difficult negotiations between

120. *Id.*

121. Komisar, *supra* note 35.

122. Stiglitz, *supra* note 61.

Argentina and the IMF.[123] These further undermined market confidence. Third, the market's obsession with the IMF made it impossible for Argentina to stray from the advice, despite its resistance. Finally, the IMF's program further slowed the economy and made it more difficult to service debt, further undermining confidence. The IMF's habit of applying the Washington Consensus blinded it to the particular needs of Argentina and may have ignored a window of opportunity to turn around the economy.

Finally, Argentina's troubles with the IMF developed in the midst of a worldwide economic slowdown. The IMF could have been more strict with its conditions on Argentina because there was a higher demand for its loans. So, instead of relaxing conditions for a country that is in a recession and needs to spend its way out, the IMF tightens the belt. As several authors have noted:

> IMF conditionality varies procyclically: It is stricter when the world is in a recession than when it is in a boom. The period from 1979 to 1982 is a particularly good example. There is econometric evidence that tightening of conditionality reduces the volume of IMF credits. One need not be a Keynesian to criticize the procyclical effect of such variations in conditionality. . . . At a time of worldwide recession, when the demand for IMF credits increases, fund officials can maximize their authority by tightening lending conditions . . . . In boom times, in the other hand, the decline in demand for credits leads to eased conditions . . . . Varying conditionality thus becomes a substitute for altering interest rates since the rates the IMF can charge are fixed in advance.[124]

G. *Pleasing the Markets*

In January 2001, the IMF added an additional $14 billion credit to the $7.4 approved in 2000.[125] The IMF praised Argentina's currency peg and expressed optimism about the economy.[126] Many leading economists called for devaluation, yet the IMF con-

123. *IMF, Argentina Negotiations Enter Sixth Day*, AGENCE FRANCE PRESSE, Aug. 15, 2001, LEXIS, News Group File.

124. PERPETUATING POVERTY: THE WORLD BANK, THE IMF, AND THE DEVELOPING WORLD, 53 (Doug Bandow & Ian Vasquez eds., 1994).

125. *IMF Approves 14 Billion Dollars*, AGENCE FRANCE PRESSE, Jan. 12, 2001, LEXIS, News Group File.

126. *IMF Praises Argentina's Currency Peg*, AGENCE FRANCE PRESSE, Jan. 26, 2001, LEXIS, News Group File.

tinued to support the currency board.[127] By this time it may have no longer mattered whether the IMF's advice was good, as international markets had fixated on whether Argentina could fulfill its conditions.[128] The government had to take into account what the markets thought the nation should do, not necessarily whether market opinion reflected the right advice economically. In turn, the IMF is pressured to construct programs that cater to market myths. According to Krugman, in Brazil, the IMF was confronted with problem of whether to tailor policies to what the market thought was the right thing to do or what the Fund believed was the correct economic advice.[129]

This poses a dilemma for advocates of free trade. In the short run, lowering tariffs will destroy jobs. A government may not be able to devalue to support competitive exports for fear of speculators, and cannot use fiscal or monetary policy to inflate the economy by printing money because it will cause capital flight. Market opinion may make it impossible to follow free market strategies because devaluation would lead to capital flight. It is difficult to tell a country that protectionism just redistributes jobs when, in that instance, it increases output and employment.[130] Of course, the loss of jobs resulting from lowered tariffs or quotas only occurs once, whereas protectionism exacts a toll on society for as long as it policies remain in place.

In May of 2001, the IMF agreed to a $1.26 billion disbursement to calm markets despite the fact that Argentina had missed fiscal targets by a wide margin.[131] In August, a $40 billion crisis package and a $30 billion debt swap had failed to convince investors the nation would not default on its $130 billion debt.[132] As bank withdrawals from deposits reached $300 million a day, police clashed with protesters. The government announced a 13% reduction of all public employees salaries.[133] On August 13, news sources began to report that the IMF and U.S. Treasury Secretary

127. *Id.*

128. *More Belt Tightening Necessary in Argentina*, AGENCE FRANCE PRESSE, Mar. 15, 2001, LEXIS, News Group File.

129. *Krugman, supra* note 27.

130. Paul Krugman, *Is the Economic Crisis a Crisis for Economics?*, 1998, http://www.pkarchive.org/crises/trouble.html.

131. *Argentina Reaches New Agreement with IMF*, AGENCE FRANCE PRESSE, May 4, 2001, LEXIS, News Group File.

132. *Stocks Close Higher as Argentine Mission Heads to U.S. for IMF Talks,* AGENCE FRANCE PRESSE, Aug. 13, 2001, LEXIS, News Group File.

133. *Argentine Markets Anxiously Await Word from Washington*, AGENCE FRANCE PRESSE, Aug. 13, 2001, LEXIS, News Group File.

O'Neill no longer believed additional funding was appropriate because a bail out would no longer work.[134]

H. The IMF Gives Up on Argentina

In August, negotiations dragged on for a $15 billion aid package that demanded further austerity measures to be implemented despite mass protests and an economy in a deep recession.[135] By late August, talks on extra funding had stalled. By this time, it was clear that the IMF and the United States did not assign systemic risk to the crisis.[136] In a widely publicized remark, United States Secretary of the Treasury Paul O'Neill insulted the Argentine people by seeming to equate their nation's importance to Uganda's.[137] Alan Greenspan, in an appearance before Congress, referred to the Argentine crisis as domestic in nature.[138] IMF officials did not want to commit the mistake of providing money that would only be eaten by the markets in days or weeks. Any bailout would have to be massive or do little good.[139] Strangely, the IMF opted for the middle path, offering $8 billion of $15 billion sought, bringing total IMF loans to $21.7 billion.[140]

By November 2001, investors were concerned of a devaluation or default as the government sought new loans from the IMF and other institutions.[141] Further access to IMF loans was blocked in December because the IMF refused to agree with the government's new program.[142] Finally, in December, the IMF wanted Argentina to devalue the Peso.[143] The currency had made Argentine companies uncompetitive as imports flooded in from Brazil, whose currency had devalued 21% in 2001.[144] The government

134. *Argentine Delegation Set to Begin Fourth Day of Talks with IMF*, AGENCE FRANCE PRESSE, Aug. 13, 2001, LEXIS, News Group File.

135. *Argentine Officials say Talks with IMF made Progress*, AGENCE FRANCE PRESSE, Aug. 16, 2001, LEXIS, News Group File.

136. *Argentina, IMF Talks on Extra Funding Bogged Down*, BBC, Aug. 19, 2001, LEXIS, News Group File.

137. *Id.*

138. *Id.*

139. *Id.*

140. *IMF Offers Argentina 8 Billion Dollars*, AGENCE FRANCE PRESSE, Aug. 22, 2001, LEXIS, News Group File.

141. *From Poster Child to Basket Case*, FOREIGN AFFAIRS, Dec. 2001, LEXIS, News Group File.

142. *IMF to Blame for Argentina's Crisis*, IPR STRATEGIC BUSINESS INFORMATION DATABASE, Dec. 31, 2001, LEXIS, News Group File.

143. John Lyons, *Argentina Bonds Fall on Report IMF wants to Devalue Peso*, BLOOMBERG, Nov. 27, 2001, http://quote.bloomberg.com.

144. *Id.*

placed restrictions on bank withdrawals to no more than $1000 a month and began to default on its debt.[145] Throughout December, the government continued to plead to the IMF for additional loans. The government announced it would cut certain tax breaks, which were once part of a stimulus package for corporations aimed at pulling the economy out of a recession.[146] Nevertheless, the IMF announced the economy would shrink for the fourth straight year.[147]

On December 18, the IMF's chief economist stated that Argentina's "fiscal policy, debt and exchange rate regime is not sustainable," that it would be the "subject of ongoing negotiations," and "the answer to the problem lies in Argentina, the solution is up to Argentina but the IMF stands ready to help."[148] Given that the IMF had largely authored Argentina's fiscal and economic program for the past ten years, does the IMF itself not share much of the blame? On December 21, 2001, the IMF defended itself, stating, "[T]he economic program of Argentina was designed by the government of Argentina and the objective of eliminating the budget deficit was approved by the Congress of Argentina."[149] In order to unblock the critical disbursement of $1.264 billion, the government had to agree to further austerity measures for the riot-racked nation.[150]

Distancing itself from the Argentine program, and denying that instability resulted from the IMF's refusal to release additional funding, an IMF spokesperson stated that the government was not going to be able to keep its pledge to eliminate its budget deficit under the current program and that Argentina was "working through the difficult option that a sovereign nation has to look at to put itself on sound financial footing," the initiative for which must come from "inside the leadership of the country" and which is not something "that can be imposed from the outside."[151] This demonstrates a pattern of the IMF attempting to distance itself from its failed policies. The IMF can always claim that the bor-

145. Thomas Catan, *IMF Denies Loan to Argentina*, FINANCIAL TIMES, Dec. 5, 2001, http://news.ft.com.

146. *Id.*

147. *IMF Warns of Further Slide in Argentina*, AGENCE FRANCE PRESSE, Dec. 18, 2001, LEXIS, News Group File.

148. *Argentina Economic Policy "Not Sustainable":IMF*, AGENCE FRANCE PRESSE, Dec. 18, 2001, LEXIS, News Group File.

149. MacEwan, *supra* note 43.

150. *Id.*

151. Emily Schwartz, *IMF Signals No Fresh Argentina Aid, Awaits New Team*, BLOOMBERG, Dec. 20, 2001, http://quote.bloomberg.com.

rowing country did not implement its program well enough, yet the repeated failure and inability of countries to implement the programs may question the truth of the claim. From 1991 to 1999, President Carlos Menem had followed Washington's injunctions in almost every detail, by dismantling the public sector, dismissing hundreds of thousands of civil servants, liberalizing the economy and foreign trade, privatizing industry, raising interest rates, and allowing 90% of its banks and 40% of its industry to end up in the hands of international capital.[152]

III. THE "WASHINGTON CONSENSUS" AND DEVELOPING ECONOMIES

There are a number of parallels between IMF activity in Russia and Argentina. The IMF stood by in both countries while billions from IMF authored privatization programs disappeared through corruption and debt service. This should have been foreseeable, and once underway, the IMF did nothing to stop it, even with full knowledge of its occurrence.[153] Both nations attempted to transform a closed, state-run economy, but inadequate constraints were adopted to curtail corruption.[154] Traditional distrust of the state led to disrespect for the rule of law, resulting in corruption and tax evasion.[155] President Duhalde, in an effort to push through his freeze on bank deposits, clashed with and ignored Supreme Court rulings,[156] recalling Yeltsin's order to shell Parliament and disband Russia's Constitutional Court. On December 1, 2001, Finance Minister Cavallo set a $250 limit on withdrawals from bank accounts; yet $15 billion had already been taken out of the country in the previous month by international speculators.[157] The Argentine people ultimately bore the brunt of the new currency limits, while the wealthy shuttled funds off shore. In a decade as the IMF's neo-liberal show state, unemployment rose from 3% to 20%, the number of people in poverty climbed from 200,000

---

152. Carlos Gabetta, *Argentina: IMF Show State Revolts*, LE MONDE DIPLOMATIQUE, Jan. 12, 2002, http://www.en.monde-diplomatique.fr/2002/01/12 argentina.

153. *Frontline: The Crash*, *supra* note 35. The IMF had knowledge that funds were being used improperly in Russia.

154. Sachs, *supra* note 35.

155. *Id.*

156. *Argentina's Supreme Court Calls Banking Freeze Unconstitutional*, ASSOCIATED PRESS, Feb. 2, 2002, http://www.detnews.com/2002/business/0202/02/ business-405944.htm.

157. Sachs, *supra* note 35.

to 5 million, and illiteracy grew from 5% to 32% as education and government budgets were slashed.[158] Such impressive numbers are only surpassed by Russia, which in the time of its relationship with the IMF saw its real per capita gross national product drop by almost 40 percent, a turn of fortunes unprecedented in world history during peacetime.[159]

One possibility is to have country specialized teams or programs designed by the borrowing governments themselves. Previous country-tailored programs designed by member governments justifiably take into account the complex set of circumstances in each country.[160] "The most novel and successful stabilization programs of the past ten years, whether in Bolivia, Estonia, Israel, Mexico or Poland, are those that were designed by country teams, often over the IMF's initial objections."[161]

What is particularly disturbing is that what studies have been done show no correlation between IMF programs and economic growth.[162] IMF staff economist Moshin Khan found that the programs had a non-significant effect on balance of payments and inflation, a positive effect on current account balances, and a significant negative effect on output.[163] In other words, the programs moved the current account toward balance by reducing output, income, and imports.[164] A study by the Heritage Foundation found that in terms of per capita wealth, of the eighty-nine loan recipients from 1965 to 1995, 54% were no better off compared to the time they received the first IMF installment.[165] Of these countries, 35% were poorer, of which almost half had economies which had been reduced by 15%.[166] Moreover, if investor confidence were the key for a recovering economy, it would seem that limiting corruption would also be important to the IMF. Yet, the IMF, no less in Argentina than in Russia, Korea, and Indonesia looked the other way as even the money it loaned was used for corrupt purposes.[167] The countries with the best globalization records, such as China, India, and Botswana, never had IMF programs. Further-

158. *Id.*
159. McQuillian, *supra* note 62.
160. *The IMF and the Asian Flu*, *supra* note 35.
161. Jeffery Sachs, *IMF, Reform Thyself*, WALL STREET JOURNAL, Jul. 21, 1994, *available at* http://www.imfsite.org/reform/sachs2.html.
162. *See generally* Meltzer, *supra* note 79.
163. *Id.* at 208.
164. *Id.*
165. McQuillian, *supra* note 62.
166. *Id.*
167. Meltzer, *supra* note 79.

more, the only empirical study on the relation of capital market liberalization as defined by the IMF and economic growth has found no correlation.[168]

IV. Transparency and Democracy

IMF programs are difficult to judge objectively because of the lack of transparency in the decision-making process. IMF officials, as reported in a Washington Post article, claimed to believe all along that the currency regime was the wrong monetary approach for Argentina.[169] Although on previous occasions the IMF had announced that it supported the peg. The lack of transparency and secrecy in the organization makes it impossible to objectively evaluate IMF performance. It should not be so difficult to determine whether the IMF's support of a currency regime may have been a critical factor in the economy's collapse. IMF head, Horst Koehler, recently admitted that the IMF did not pay enough attention to the drifting of Argentina's economic policies in the late 1990s, and shared "the failure with the whole international community."[170] Such vague admissions are hardly helpful in understanding exactly what occurred within the Argentine program.

Leading economists have demanded published reports, audits, and opinions be published.[171] Prolonged studies and consultation with outside experts are not always possible in a rapidly developing crisis.[172] Nevertheless, preserving better records of the internal process will serve to stimulate healthy criticism after the mission is completed. The executive board should not automatically approve the proposals submitted by staff. It must consult outside experts and make operations public so that objective criticism and review can take place. The IMF does not disclose its agreements with borrowers, although the country is free to do so.[173]

Although Washington preaches democracy, the IMF conducts

168. Joseph Stiglitz, *Globalization and its Discontents: How to Fix What's Not Working*, Lecture at the University of Manchester (April 4, 2001), *available at* http://idpm.man.ac.uk/idpm/stiglitz.html.

169. Pearlstein, *supra* note 14.

170. Patrick Moser, *Argentina Working with IMF, Which Recognizes Past Failure*, AGENCE FRANCE PRESSE, Jan. 22, 2002, LEXIS, News Group File.

171. *The IMF and the Asian Flu*, *supra* note 35.

172. Stiglitz, *supra* note 31.

173. Jeffery Sachs, *The IMF is a Power Unto Itself*, FINANCIAL TIMES, Dec. 11, 1997, at 4.

itself like a dictator. Those most affected by the IMF's policies have little influence on the conditions imposed. In Korea, the IMF insisted that all Presidential candidates endorse an agreement they did not draft, negotiate, or understand.[174] Stiglitz criticizes the IMF because it imposes its conditions without time for consensus building and public debate. When a crisis explodes there may not be time for such measures but in a slowly building crisis, such as that experienced in Argentina, and arguably Russia, the IMF should have worked out a compromise with the Argentine government. The facts presented tell only a partial compromise with the Argentine government and much of the old habit of imposing conditions. Furthermore, the IMF frequently uses teams that have little or no experience with the country. The IMF does not have enough outside consultants and objective criticism of their decisions.

The United States is not moving gracefully into the multipolar future. One problem with changing IMF policy is that the IMF does not necessarily agree with the values inherent in the arguments of this comment. As Charles Calomiris has recognized,

> To some, the IMF should be a vehicle for leveraging U.S. foreign policy. From this point of view, IMF limits on flexibility, independent evaluation of performance, and transparency are undesirable. For example, the U.S. government told Pakistan that IMF lending was conditioned on signing a nuclear nonproliferation treaty. This undermines the economic effectiveness of the fund, having to serve ad hoc foreign policy goals over the greater concern of promoting stable economic development around the world. It forces the IMF to depart from procedures, thus undermining its integrity.[175]

V. CONCLUSION

While no one organization can be blamed for Argentina's collapse, and no single measure could have prevented such a complex event, certain lessons can be gleaned from a study of the relationship between Argentina and the IMF. The Fund pressures nations to get their fiscal house in order to attract investor capital. However, if budget cuts lead to the decimation of social programs, which are all the more necessary during a crisis, fiscal control may lead to results contrary to its purpose, the stabilization of the

174. Pearlstein, *supra* note 14.
175. Calomiris, *supra* note 104.

economy. Riots and social instability do not attract investment, but fuel capital flight.

Fighting devaluation by maintaining a rigid currency regime may slow inflation and make governments popular, but may in the long run undermine an economy. Adopting a floating exchange rate could often make borrowing from the IMF unnecessary.

Insufficient financial regulation, combined with moral hazard, leads to irresponsibility in the private sector. The poor are left to pay for IMF bailouts that often simply serve to enable wealthy investors to shuttle capital out of the country. The IMF could expand conditionality to extending the social safety net, such as requiring borrowing nations to hold a certain amount of unemployment insurance.

Tight restrictions on capital flows can hinder investment and lead to capital flight. On the other hand, capital market liberalization for countries in the early stages of developing a market economy is very risky. The IMF advises largely unrestricted access to imports and foreign investment. Yet, the world economic success stories argue otherwise. Britain, the United States, Japan, Western Europe, Taiwan, and South Korea all built foundations for development on government regulation of trade, banking, and investment.[176] This line of criticism has been somewhat effective, as the IMF is now recognizing the need for greater regulation in the banking and financial sectors in developing nations.

Some regulation of foreign investment is necessary because the social risk is often greater than the private risk. The investor imposes greater risk on society than is borne by him alone. Risky investors must share the risk in actuality, not just in theory. A tax could be placed on certain transactions to increase the cost of "round tripping." Foreign investors often make high interest short-term loans and then pull the money out of the country when the term expires. When this is done on a large scale due to some real or perceived economic emergency, the resulting capital flight can destabilize the economy. A tax on every short-term loan could be used to create a social fund to be utilized in the event of a crisis. Further, IMF loans could be conditioned on minimizing the percentage of foreign debt held short-term. In addition, freezing capital outflows provides time to assess burden sharing, and the creation of an international bankruptcy court could serve to this

176. MacEwan, *supra* note 43.

end. Finally, the United States may require, as a duty of United States corporate citizenship, that companies of substantial wealth invest long-term in developing economies that have made every effort to attract investment. For example, Bulgaria, in the eyes of the IMF, World Bank, and the U.S. Treasury, has for years been doing everything right to create an investor-friendly environment. Yet, for some reason capital still stays away. These market economy wallflowers must be brought into the dance, or capitalism may eventually be discredited.

Economic policy is perhaps the most important way in which the United States interacts with the world. Yet, "the culture of international economic policy in the world's most powerful democracy is not democratic."[177] Part of the tragedy is that the United States does not practice what it preaches. American protectionism can be partly blamed for the Argentine crisis. The United States promulgated the "open your markets" mantra while keeping its own closed. Argentina could greatly benefit from free trade with the United States because it would have a comparative advantage in food products, such as beef, and textiles, such as leather. However, American protectionism in these areas erases this potential advantage. Why did the United States not consider lowering some of these tariffs to help Argentina's economy when the country entered a recession and fell further into debt?

The double standards are obvious to all. The United States itself does not practice tight fiscal policy when it is in a recession, yet it has repeatedly advised others to do so. Pursuing the standard IMF formula during a recession, of implementing fiscal measures and austerity programs that often cause the economy to contract, may dramatically worsen the economic situation. Moreover, after the savings and loans debacle and the regulation that followed, the United States preached the gospel of market deregulation around the world.

Developing nations should work as a bloc to negotiate agreements and preconditions with the IMF. The threat of repudiation could be an effective bargaining tool. Latin America may better serve its interests not by joining a Free Trade Area of the Americas (FTAA), but by strengthening and enlarging MERCOSUR to create a customs union. Further, it is essential for IMF boards to have greater representation and input from developing nations.

177. Komisar, *supra* note 35.

VI. UPDATE ON THE ARGENTINE CRISIS

Nine months after the $141 billion default and collapse of the Argentine economy, the nation remained mired in a depression and unable to convince the IMF to provide new loans. As of September 2002, unemployment stood at 21.5%, 53% of Argentines have fallen below the poverty line, and the economy has lost more than 20% of its GDP since the last business cycle peak in 1998.[178] The continuation of Argentina's economic collapse occurs amidst a backdrop of reports that U.S. policy is fueling populism in South America.

> [U.S. policy] largely consists of a drug war aimed at peasant coca growers, regular but empty promises of trade expansion and a constant flow of international aid that chiefly serves to prop up corrupt officials and defend the status quo. The Washington Consensus applauded the sale of state utility companies across South America to private monopolies, even though that once again left the region's poor at the pricing mercy of the traditional elite.[179]

Opposition is building in South America to the decades-old free-market experiment as demonstrated by the recent victories of leftist politicians like Luiz da Silva in Brazil and ex-colonel Lucio Gutierrez in Ecuador's presidential run-off.[180] The market reforms ushered in after the global collapse of communism are facing increasing resistance due to the upheavals in the region and may threaten the prospects for a FTAA.

While Argentina has recently convinced the IMF to postpone loan repayments of $1 billion and $2 billion, and negotiated a $500 million debt swap between the Inter-American Development Bank and the World Bank, the nation has yet to procure new loans from the IMF or convince the IMF it has marshaled the political consensus to undertake the necessary reforms.[181] Although Argentina defaulted on its public debt, reneging on obligations to multilateral lending institutions such as the IMF or World Bank would

---

178. Alan B. Cibils, Mark Weisbrot, and Debayani Kar, *Argentina Since Default, The IMF and the Depression*, CENTER FOR ECONOMIC AND POLICY RESEARCH, Sept. 3, 2002, http://www.jubileeplus.org/analysis/articles/briefing090902.htm.

179. *Argentina Looking for World Bank Money*, WORLD BANK GROUP: DEVELOPMENT NEWS CENTER, July 15, 2002, http://www.debtchannel.org/themes/country.

180. *Argentina: Predictions Grow Gloomier*, WORLD BANK GROUP: DEVELOPMENT NEWS CENTER, Jul. 22, 2002, http://www.debtchannel.org/themes/country.

181. *Argentina: IMF Defers Loan Payment*, WORLD BANK GROUP: DEVELOPMENT NEWS CENTER, Jul. 17, 2002, http://www.debtchannel.org/themes/country.

transform Argentina into a financial pariah.[182] To further complicate matters, the IMF may be especially cautious about lending this time around as the last IMF loan of $8 billion in August 2001 is widely viewed as a mistake that only served to finance the same capital flight for the wealthy, for which the IMF has long been criticized.[183]

Still, it remains doubtful whether the IMF could ultimately have done anything to effect a different outcome. Helie de Pourtales, a former head of the International Department of Lazard Freres, notes,

> The fundamental cause (of the crisis) is in the constitution, written in 1853 when it took two months to go from North to South by horseback. There are 24 parliaments, 24 ministers of finance, 24 ministers of health - 24 of everything, if you include the central government. The 23 provincial governors are all powerful makers of Presidents and politicians. They can borrow and spend all they like and then shove the responsibility onto the federal authorities, which cannot do much about it.[184]

It is typical that in the recent round of negotiations with the IMF, this time over the plan to unfreeze bank deposits, the IMF is frequently confused by varied and discordant messages emanating from Argentina's government.[185] Further discord results from different branches of the government clashing over fundamental aspects of the crisis program. Argentina's Supreme Court has held unconstitutional the widely unpopular banking withdrawal freeze.[186] On October 12, 2002, Congress shelved impeachment proceedings against all nine justices of the Supreme Court, which President Duhalde sought after his efforts to prevent depositors from withdrawing money from their bank accounts were ruled unconstitutional.[187] Since then, the high court has constantly thwarted Duhalde, reversing government increases in utility rates and salary and pension cuts, and leading the IMF to complain

---

182. *Id.*

183. *Argentina to Skip Paying Loans*, WORLD BANK GROUP: DEVELOPMENT NEWS CENTER, Sept. 26, 2002, http://www.debtchannel.org/themes/country.

184. *Argentina: Predictions Grow Gloomier*, *supra* note 180.

185. *Financial Tango Continues in Argentina*, WORLD BANK GROUP: DEVELOPMENT NEWS CENTER, Sept. 6, 2002, http://www.debtchannel.org/themes/country.

186. *Argentina's Supreme Court Calls Banking Freeze Unconstitutional*, ASSOCIATED PRESS, Feb. 2, 2002, http://www.detnews.com/2002/business/0202/02/business-405944.htm.

187. *Argentina: President Fails to Unseat Court*, N.Y. TIMES, Oct. 12, 2002, LEXIS, N.Y. Times File.

that a lack of political consensus was impeding a new loan agreement with Argentina.[188] Moreover, fueled by the popular sentiment of bank bashing, Congress has recently blocked a plan to turn frozen bank deposits into bonds.[189]

These recent difficulties are typical of what the IMF has had to face throughout its history with Argentina. If the Argentine government cannot agree upon an economic program, how can the IMF be expected to find an effective program for it? However, if this is a valid defense for the IMF, it ultimately leads to questions of whether the IMF should remain in the business of lending during crisis situations.[190] Further, any criticism of the IMF's actions must consider whether different advice, even if the Argentine government had been persuaded to adopt it, would have had any beneficial effect. For example, if the devaluation of the Peso had occurred earlier, might the unpopularity of the action have led to the same social unrest the IMF is often accused of causing?

To complicate an ultimate assessment of the IMF's advice, Argentina's downward spiral may be coming to an end and the economy may be on the verge of recovering as a result of the natural economic processes that come into play following devaluation. This seems to be occurring despite the nation's inability to obtain further IMF loans. There is a current account surplus as a result of devaluation making exports more competitive and decreasing the ability of Argentines to afford imports.[191] Therefore, the nation is capable of paying for imports in the foreseeable future without further borrowing.[192] Based on this analysis the economy may be set to recover without new loans from the IMF. Argentina's economy is beginning to resemble a replay of Russia's post-crisis recovery. After years of fighting recession, debt payments, and an overvalued currency, the 1998 crisis and devaluation spurred the Russian economy into its current four years of unprecedented growth as imports decreased due to diminished buying power, spurring domestic industry to rapid growth as a result of a devalued Ruble.

Nevertheless, there is a growing agreement among econo-

188. *Id.*

189. *Some Good News for Argentina*, WORLD BANK GROUP: DEVELOPMENT NEWS CENTER, Sept. 9, 2002, http://www.debtchannel.org/themes/country.

190. *See* Press Release, Joint Economic Committee, *IMF Reform May Be Mandated by Congress* (Mar. 13, 2000), *available at* http://www.house.gov/jec/press/2000/03-13-0.htm.

191. *See* Cibils, *supra* note 178.

192. *Id.*

mists that given the political, social, and cultural complexity of economic crises, the simplistic application of the Washington Consensus, which acts as a procrustean bed in which inefficient, broken economies are "fixed," is no longer a viable approach. The IMF's mission in the future will hopefully be to help solve economic problems and not simply promulgate an approach based on a rigid economic philosophy. There is a range of policies that must be selected based on conditions in each country. Still, it is not clear that much has been learned from the mistakes. Nine months after Argentina's foreign debt default, IMF projects such as Brazil, which is in peril of defaulting on its $250 billion debt, Turkey, and Uruguay, are on the brink of crisis, giving rise to the belief that little progress has been made to halt the string of serial busts plaguing developing economies.[193] The crisis in Argentina is an example of what can occur when a dogmatic formula of macroeconomic ideals descends into social reality. When the ideal becomes grotesque and absurd by the time it reaches down to the people it was intended to help, the substance of the ideal and the process of its application must be reconsidered.

JOHN V. PADDOCK*

---

193. *Argentina: Predictions Grow Gloomier*, *supra* note 180.

* Juris Doctor Candidate, May 2003, University of Miami School of Law.