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Argentina and the IMF

By Arturo Porzecanski on September 17, 2021

IMAGE CREDIT

Argentina and the International Monetary Fund (IMF) have had a long and contentious relationship. Since becoming a member of the Fund in 1956, successive governments in Buenos Aires have sought and agreed to **21** emergency financial-support programs, most of them lasting fewer than 24 months. Outside Argentina, that record is evidence of the country's frequent economic mismanagement. Inside Argentina, it is the rescue programs, rather than the fiscal, monetary and political causes of the country's financial emergencies, that have come under most criticism, roundly disparaged as ill-conceived, excessively harsh and overall disappointing.

Their **unpopularity** is such that many an Argentine **finance minister** and many an IMF **senior staffer** have had their careers shortened for alleged program design or implementation flaws. "*Ajuste*" – Spanish for "adjustment," but IMF code for belt-tightening – is a four-letter word.

The Argentina-IMF relationship has been simmering as of late, but it will come to a boil early next year over the repayment of a huge and **controversial** loan granted to the predecessor government of Mauricio Macri that was disbursed between mid-2018 and mid-2019. The first two principal repayments come due next week and in December, totaling $3.8 billion, and it **has been** the government's intention to pay. After all, Argentina recently received from the Fund **its share** – $4.3 billion – of a worldwide distribution of IMF-issued electronic credits, known as Special Drawing Rights, exchangeable for any national currency or purpose.

This windfall is part of a **global effort** to provide funding to the world's governments to cover costs associated with their pandemic response. In many low- and middle-income countries, the credit will likely underwrite the expense of COVID-19 vaccine imports and other public health and social measures, but the plan is for Argentina to use this gift to meet its upcoming installments to the IMF.

However, the repayments to the IMF scheduled for next year and beyond are another matter. They **total about** $18 billion in 2022, $19 billion in 2023 and $5 billion in the first half of 2024 – $46 billion altogether from mid-2021 to mid-2024, plus accrued interest. There **is neither** political support nor fiscal savings to pay those sums without significant new external funding.

Beyond having defaulted on its obligations to bondholders last year in order to obtain better terms, Argentina is now showing a reluctance to keep up with its payments due to foreign governmental entities. In May, Argentina was supposed to pay a little over $2 billion to a variety of official foreign aid and export-finance agencies **represented** by the Paris Club. It failed to do so, **claiming** it didn't have dollars to spare. To avoid default, in June the government **reached a deal** with the Paris Club to pay less than one-fifth of that amount between now and March 2021, with the rest to be determined.

That brinksmanship must have discomfited the Fund. After all, the $2 billion Argentina owes Paris Club creditors is small change compared to its IMF debt, and it should have been affordable. Consider that during January-July of this year, **Argentina earned** on average $6 billion *per month* from merchandise exports, yielding significant tax revenues that could have covered the Paris Club debt.

From the day they came into office in December 2019, President Alberto Fernández and his finance minister, Martín Guzmán, have made it plain to the IMF that they would seek a new loan large enough to cover the payments on the Macri-era bailout. (The IMF does not reprofile its own loans, so that is not an alternative.) The two sides have been exchanging views from time to time, but the country's powerful vice president, Cristina Fernández de Kirchner, has been vocal in denouncing the IMF and **blocked** any attempt to finalize an accord before the November 14 midterm elections.

Given Argentina's poor investment climate, chronically bleeding fiscal accounts, high inflation (averaging 45% annually during the past three years), anemic economic growth and deepening poverty, Fund staff reportedly advocate significant fiscal, monetary and structural reforms. "A credible and strong macroeconomic and structural plan that can be supported by the international community is needed," a **recent IMF report** urged.

And rightly so: for Argentina's sake and for the Fund's own financial health, the IMF should insist that the government adopt sensible policy initiatives to improve its fiscal accounts and international competitiveness, thereby regaining the confidence of local and foreign investors. Otherwise, the funds needed to pay down the IMF's next loan will never be generated, and the Fund would be throwing good money after bad.

Nevertheless, there is little appetite within the Peronist ruling coalition for cuts to bloated government spending, including a multitude of welfare schemes and costly subsidies to consumers of public utilities; tax reforms to lessen the crushing burden on farms and industries; deregulatory initiatives and private-property protections to improve the business climate; or a tighter monetary policy to reduce galloping inflation, despite price and currency controls.

Complicating matters is the governing coalition's **unexpectedly poor** performance in primary congressional elections last Sunday. Peronist candidates attracted far fewer voters than did opposition candidates belonging to the coalition that Macri led in 2015. This included many congressional districts traditionally loyal to Peronism, such as the Province of Buenos Aires, which holds more than a third of the country's electorate. If the population were to maintain its revealed preferences until the elections in mid-November, the Peronists would lose not only their advantage in the lower house, but also their decades-long majority in the senate.

The **question now** is whether Alberto Fernández will adopt more sensible economic policies to win back independent and absentee voters, or if he will double down on populist policies to fire up his base. The former approach would ease the path to an agreement with the IMF, while the latter would complicate the negotiations in Washington.

Chances are that Fernández will open the fiscal and monetary spigots during the next two months to put more money in people's pockets. It is likely that his government will **quickly approve** hikes in pensions, subsidies and support payments under various social programs. Moreover, it will probably support a bill to force upward wage readjustments in the private and public sectors, one that has just **been introduced** in the lower house by Peronist lawmakers.

Once the midterm elections have passed, however, and regardless of their outcome, the direction of public policies could change. This possibility opens up three scenarios for Argentina's quest for another outsized loan from the Fund, under the **Extended Fund Facility** (EFF), that would cover most of the huge payments to the IMF due in 2022-24.

First scenario: Early next year, the government decides to change course and adopts an emergency economic stabilization and structural reform plan that not only passes muster with the IMF, but also attracts the support of at least some opposition deputies and senators. (By recent law, any program with the IMF **must be approved** by the legislature.) Equally important, the stabilization plan induces investor confidence and improves the government's access to the voluntary capital markets, allowing for reduced dependence on central bank financing of any remaining fiscal borrowing requirements.

Such a plan strengthens the country's economic recovery, curbs inflation and supports the Argentine currency.

Second scenario: Argentina and the Fund remain far apart on the terms and conditions of an EFF because there is no political backing for the kind of orthodox economic policies that would be viewed as a national surrender by core Peronist supporters. The relationship breaks down and the Fernández government defaults on its payments to the IMF.

To be sure, such a rupture would be highly problematic for both sides. A number of countries **have defaulted** to the IMF in decades past, but mostly in the 1980s and 1990s, for brief periods, and involving small amounts. But a default, never mind a protracted one, by Argentina on the Fund's **largest-ever loan** would be a huge embarrassment for the institution.

As to the consequences of a no-deal, default scenario for Argentina, they could be dire. News that Argentina has failed to agree on a sensible economic program with the IMF, and is willing to default to its most senior foreign creditor, might spark a stampede out of bank deposits and a massive run on the Argentine peso, precipitating a hyperinflationary spiral, a financial crisis and political instability.

Third scenario: The government offers the IMF only modest fiscal and monetary adjustments and timid structural reforms, backed by a not-so-veiled threat to walk away and default on its payments if its offer is rejected – and the IMF's management and leading shareholders decide to go along and approve a new loan.

This scenario, of a "kinder and gentler," but far less promising, IMF stabilization and reform program has two advantages. First, it keeps Argentina engaged with and honoring its debts to the IMF, establishing a mechanism for frequent consultations and negotiated course corrections as circumstances warrant, such that the program might become more ambitious and successful over time. Second, a low-conditionality loan might buy the Fund two years until Argentina's next national elections take place, in October 2023, after which a new administration might take over with a more responsible and market-friendly agenda.

It is very difficult to assign probabilities to these three scenarios, but one thing is certain: We have not seen the final chapter in Argentina's long and tumultuous relationship with the IMF.

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