

**Testimony by Mark Weisbrot¹ before the
Subcommittee on International Monetary Policy and Trade
Committee on Financial Services
U.S. House of Representatives**

**Hearing on the State of Argentine Economic Crisis
and the Role of the International Monetary Fund**

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I would like to thank the committee, and Chairman Bereuter, for the opportunity to testify today on these matters of vital interest to the United States and the world. The Argentine economy is now suffering the worst economic crisis in its history, with unemployment of more than 22 percent, and there is no sign of recovery. It is essential that we understand, and change, the role of our own government -- including the US Treasury Department, which has the overwhelmingly dominant voice within the International Monetary Fund (IMF) -- so that Washington does not continue to worsen an already desperate economic situation which threatens to degenerate into political chaos.

From February 11-15, I met with Argentine businessmen, bankers, economists, trade union officials, members of the Argentine Congress, and non-governmental organizations. The recommendations that follow reflect what they told me, as well as the research carried out by the Center for Economic and Policy Research.

1. The IMF must acknowledge that it played a large role in causing the current crisis of Argentina's economy.

This is much more than setting the historical record straight: it is necessary to prevent the Fund from causing further damage. For example, Argentina has been in recession for nearly four years. During this time, the Fund has supported, with lending and political encouragement, fiscal tightening of the central government budget. This is something that economists in the United States would never recommend for our own economy during a recession, and it has undoubtedly worsened and/or prolonged Argentina's downturn.

The Fund also contributed enormously to the crisis by arranging tens of billions of dollars of loans to support the convertibility plan, which was clearly not a viable exchange rate regime. The result was an insurmountable debt burden, which ended in default last December. As shown below (see appendix), it is this debt trap -- not overspending by the government -- that caused the crisis.

In other words, the central government of Argentina has run primary budget surpluses (excluding interest rates) every year since 1993. But its debt service burden kept growing -- not because of spending increases, but because of rising interest rates and therefore debt. These increasing interest rates were a result of external shocks, beginning with the Fed's increase of US short-term rates from 3 to 6 percent (February 1994 - February 1995). The Mexican peso crisis (December 1994), the Asian economic crisis (beginning August 1997), the Russian (October 1998) and then the Brazilian devaluation (January 1999) all added to investors' doubts about the fixed exchange rate, and therefore to Argentina's foreign debt service and debt.

Yet the Fund, together with the other multilateral lenders that follow its lead, continued to add to Argentina's debt, even after it became clear that it could never be repaid. Argentina's currency -- under the fixed exchange rate regime -- also became overvalued, hurting its domestic industry and adding to unemployment and

slowing growth. This was not a matter of being "over-indulgent," as is it often portrayed -- it was a case of lending to support a set of bad policies that eventually brought the economy to ruin.

2. The IMF, World Bank, Inter-American Development Bank, and other official creditors should declare a moratorium on Argentina's debt service payments until the economy has recovered from the recession and achieved solid growth for at least a year.

This is the very minimum that these institutions can do to avoid worsening the crisis. Since the Fund presently functions as the leader of official (and often private) creditors, its decision -- and therefore the decision of the US Treasury department -- to declare a moratorium on debt service would help remove much of the uncertainty that now hangs over Argentina's financial future. Furthermore, the Fund could persuade private creditors to observe a similar moratorium. During this time, negotiations for a write-off of debt, and rescheduling of debt that will be paid, could proceed. As noted below, the multilateral lenders increased their lending from \$15 to \$33 billion, from December 1995 to September 2001, as private sources dried up. This was a bad gamble on their part, to support a non-viable policy (the fixed exchange rate regime). The official creditors should be prepared to write off debt that was incurred as a result of their own, easily preventable, errors.

An official moratorium on debt service is extremely important, because that is the biggest cloud that hangs over the Argentine economy. Unlike other economic crises, this one does not involve an economy that is living beyond its means: there is neither a domestic (central government) spending imbalance, nor a (foreign) balance of payments problem. The government has been running a primary budget surplus, and the economy has a trade surplus. In other words, there is no "adjustment" that is necessary, if debt service payments are suspended. Further adjustment, along the lines historically pursued by the IMF would likely only prolong the recession.

3. The IMF (and US Treasury) should not try to impose austerity conditions on Argentina, and they should not take advantage of the crisis to impose other conditions for opportunistic or ideological reasons.

There is evidence that the IMF is continuing to push for budget cuts, despite the deepening recession. In fact, late last year it reported approvingly that Argentina had reduced its structural budget deficit by percent of GDP -- the equivalent of a \$200 billion tax increase in the United States -- in the middle of a severe recession. The Fund should not be trying to squeeze the Argentine government so as to get a better deal for foreign creditors. These lenders knew they were taking a risk, and received very high interest rates as a risk premium -- more than 20 or even 30 percent in the last year and a half before default. Furthermore, by dragging out negotiations

with the government of Argentina, and insisting on unnecessary austerity, the Fund is adding the uncertainty that undermines economic recovery.

I spoke with Argentine businessmen who told me that Spanish banks want to open lines of credit to Argentine companies, but they are waiting for the IMF to reach agreement with the government. This is but one example of how this creditors' cartel, headed by the IMF, can impair economic recovery in a time of crisis.

During the Asian financial crisis, the Fund imposed more than 140 conditions on Indonesia as part of a loan package. As a result, the Fund's main impact was to get the government to guarantee private loans, rather than promote economic recovery. More than four years later Indonesia still has not reached its pre-crisis level of GDP. It would be a tragedy if the IMF led a similar "bailout" in Argentina.

4. The first priority of any economic program must be to revive spending and production, and pull the economy out of the depression.

Many people have pointed to a host of long-standing problems -- corruption, the deep distrust of politicians, lack of confidence in the banking system, etc. -- as the "root causes" of the crisis. Unfortunately, it is convenient for those who contributed to the crisis to pretend that it is all the result of deeply rooted, intractable problems in Argentine society and governing institutions. While many of these problems exist, it is neither necessary nor sufficient to cure them, in order to jump-start the economy.

The functioning of the financial system must be restored, in the wake of the default, at least to the point where producers can get credit to purchase necessary inputs, including imports. The "corralito" -- the freezing of deposits in the banking system -- will have to be gradually lifted. The "peso-ification" of the economy must succeed to the point where people are willing to hold pesos, with a relatively stable exchange rate.

These are urgent priorities for the economy, and there are even more urgent needs for the rapidly growing population of poor people, who are in need of health care, employment, and in many cases even food. Any economic recovery program should target those most in need, and the government may have to play a leading role in stimulating demand until the confidence of both private investors and consumers is restored. Here it is especially important that the IMF and Treasury do not prevent such measures for ideological reasons, or for the purpose of getting earlier or larger repayments of the foreign debt.

5. The IMF should state publicly what it is demanding from the Argentine government.

The complete lack of transparency in the negotiations between the IMF and government of Argentina invites abuse and corruption, and thwarts democracy in Argentina. Since the IMF's approval is presently a prerequisite for most other lending, the Fund has enormous power, especially in a crisis situation. If the IMF wants the government to cut its spending or raises taxes during the recession, it should say so. If the Fund wants a better deal for the foreign banks in terms of how much they will absorb the costs of devaluation, this should also be public information. There is no legitimate reason to keep these demands secret, other than to hide the process of decision-making from the public.