Recent developments in Argentina have captured the attention of Washington for good reason. Analysts have long warned the historically low interest rates that prevailed since the global financial crisis would eventually reverse, and when they do, countries with large economic imbalances (e.g., fiscal and current account deficits) would be vulnerable. The so-called taper tantrum, the strong market reaction starting in May 2013 when the Federal Reserve commented on the eventual need to unwind unconventional monetary policy, was an effective warning to countries with large deficits that financing those deficits would be difficult once interest rates start to rise. Several “at-risk” countries took note and reduced their deficits. In today’s environment, with interest rates rising and the U.S. dollar strengthening, many of these countries are no longer cited as particularly exposed to changing market conditions.

Argentina followed a different path and now has been identified by financial markets as vulnerable. Since the election of Mauricio Macri to the presidency in 2015, progress has been made to restore transparency and efficiency to government operations. But financial markets have their own timeline, and in the current environment, investors are skeptical of a gradualist approach. Argentina’s problems are mostly a legacy of the policies of previous governments, laid bare by changing global conditions. How the situation evolves from here depends on Argentina, the International Monetary Fund (IMF), and its largest shareholder, the United States.

While not the subject of this column, the long and complicated history of IMF program engagement with Argentina should be acknowledged. This history translates into skepticism from a weary Argentine public and raises the bar for requesting an IMF program. Argentina’s decision to request IMF assistance, though politically difficult, is the right call. The Argentine authorities and the IMF have wisely communicated the purpose behind IMF assistance as smoothing Argentina’s adjustment in order to “protect growth, job creation, and social cohesion in Argentina,” pushing against the false narrative that portrays the IMF as “the promoter and vehicle of politics which provoked poverty and pain.” At the same time, the Argentine authorities recognize that market confidence can only be restored and sustainability secured in the context of a credible adjustment program, which means the fiscal deficit must be reduced. Striking the balance between needed adjustment and support for economic activity is a challenge but one that can be met with the right policy mix and clear communication of policy intentions.

It’s worth highlighting that IMF financial support for Argentina is squarely in line with the IMF’s original aims of making resources available to countries experiencing balance of payments difficulties. With an informal board meeting on May 18, IMF management appropriately demonstrated a willingness to make available “exceptional access” resources to Argentina to restore market confidence and smooth the adjustment path. Importantly, the fact that any IMF financial support will come in the form of a traditional “Stand-By Arrangement”—the IMF’s workhorse lending instrument for emerging and advanced market countries—means there will be conditions and quantified economic targets attached to disbursements. The decision to pursue a traditional IMF program—rather than a credit line without conditionality—acknowledges the difficult reality that Argentina’s economy must adjust to restore confidence and put the economy on a sustainable path.

Statements from the United States in support of the economic reform program of President Macri and Argentina’s engagement with the IMF are helpful in conveying the Trump administration’s support for Argentina and backing for the role of the IMF in dealing with balance of payments crises more generally. While the former might well have been expected given the positive relationship between the two countries’ leaders, the administration’s support for engagement with international financial institutions could not be taken for granted. Reliance on the very tools of the international system that the United States helped...
create, to advance reforms that are essential for private sector-led growth and higher living standards, is positive for Argentina, the United States, and the global economy.

What would happen if the IMF weren’t available to provide support? In the case of Argentina, this is not a hypothetical. It was only a few years ago that the IMF resumed annual “Article IV” surveillance reports of the Argentine economy after a decade-long hiatus. Prior to 2016, relations between the authorities and the IMF (not to mention data quality) had deteriorated to the point that annual surveillance was impossible. When funding pressures arose, and in the absence of IMF engagement, Argentina reportedly relied on a currency swap line with the People’s Bank of China (PBOC) to meet financing needs.

Argentina was not alone in relying on PBOC swap lines; an analysis by the Federal Reserve Bank of San Francisco estimated the total value of currency swap agreements as of May 2015 was just under $500 billion, which compares with the IMF’s total quota resources of just under $700 billion. Unlike IMF lending programs, central bank swaps generally lack the conditionality to address the economic imbalances that give rise to funding needs in the first place, nor do they provide the data and policy transparency that is essential to good governance. While some critics may challenge U.S. support for the IMF, it’s hard to see how withholding support for the IMF would work in the U.S. national interest. If the United States wants to support a pro-reform government, it has two choices: provide unilateral assistance, or rely on the pooled resources of a multilateral institution that was created for this very purpose. Not surprisingly, the administration has wisely chosen the latter.

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Simon Says...

Ironically, Argentina maybe the most straightforward of the possible crisis scenarios on the horizon to address. As this month’s GEM goes to print, two other economies are generating far greater uncertainty in international financial markets: Turkey and Italy. These three countries each face distinct vulnerabilities, but the presence of political will is what currently sets Argentina apart. The Macri government in Argentina had already committed to economic reforms prior to the recent market turbulence. In contrast, Turkish president Recep Tayyip Erdogan’s rhetoric, calling interest rates “the mother and father of all evil,” has exacerbated his country’s economic and financial vulnerabilities. With presidential and parliamentary elections scheduled for June 24 and local elections scheduled for early 2019, it’s difficult to see how Turkey would currently meet the IMF’s requirements for a large (“exceptional access”) program. Specifically, the IMF requires that policies under an “exceptional access” program provide a reasonably strong prospect of success, “including not only the member’s adjustment plans but also its institutional and political capacity to deliver that adjustment.” To the extent political will in Turkey is the biggest obstacle to avoiding a full-blown crisis, a dramatic change in rhetoric and policies is needed to get the situation under control. Italy’s political challenges are no less daunting. While the veto by Italy’s president, Sergio Mattarella, of a eurosceptic finance minister has bought some time, fundamental issues related to Italy’s membership in the eurozone remain and will come to the fore as Italy heads into elections later this year. It’s too early to make predictions, but hopefully memories of the euro area crisis, which began in 2010, are fresh enough in Rome, Brussels, and Frankfurt to avoid a full-blown crisis.