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THE BATTLE FOR ARGENTINA

Ricardo Caballero and Rudi Dornbusch
Massachusetts Institute of Technology

IMF negotiations underway now offer both an opportunity to create a beachhead for stabilization but also a risk that the two sides will focus on their respective political concerns and fail to address the Argentine crisis in its full dimension. The issues are clear: both parties obviously wish for an Argentine recovery. But after that, President Duhalde wants the money the IMF can bring, a lot and fast please, but is reluctant or unable to deliver dramatic reforms; he has to deal with governors who face just the same problem as he does. On the other side, the IMF has a great dilemma. They cannot afford to be intransigent to the point where Duhalde falls. Yet, having lent into failing Argentine programs for years, they cannot do business as usual, close their eyes and put the money on the table. On the contrary, they may put up maximal demands of fierce Hooverian budget cutting in the midst of a depression.

Where is the common ground? If the maximal strategy wins—one cannot quite see how Duhalde can underwrite it—the Argentine economy will capsize and become ungovernable. If the minimal strategy wins, nothing has changed except one more element of hope gone. But this discussion misses a very critical point. IMF money, and the reforms that must accompany it, are not an end in themselves. On the contrary, they should be the lever with which to bring back capital—Argentine and foreign, from abroad.

The IMF does not have much money to give. The key role in Argentina's reconstruction has to be private capital. How then can the negotiations be turned toward a Win-Win outcome? Clearly they must reach further than short-term targets on the budget. They must include specific reforms to reach a comprehensive scheme of implementation that gives the confidence that this is not yet another program soon to be pushed aside by election priorities. We have advanced a plan to provide just the extra that is needed: a program where Argentina agrees, and indeed solicits, a foreign stabilization commission that runs the central bank and, in exchange for the disbursement of an important stabilization loan, has control of the budget implementation. Since its publication, our proposal has attracted a lot of discussion, not all favorable by any means. But, importantly, two opinion surveys in Argentina have revealed support of upward of 40 percent of the sample. That is astounding support, and political ammunition, for a scheme that would create a major boost in Argentina's external credibility. Better credibility in the capital market, to some extent, carries the bonus of a lesser need for fiscal heroics—an obvious point that President Duhalde must not miss.

Let us revisit the plan and the reactions. We made the case that this crisis is far worse and more dangerous than anything either Argentina or any other major emerging economy has seen in recent decades. The very foundations of a modern society are being cannibalized. Sadly, many Argentines could recognize the symptoms we described. Those that didn't at first, are being persuaded by the unfolding events.

Our prescription, that Argentine financial and economic sovereignty be given up for a few years, was not received with equal consensus. Those that object, see in our proposal an attack on

national pride. We think this perception is misguided; a country is far more than a set of monetary, financial and fiscal rules. National identity and pride are not given up by accepting that a few foreigners monitor the implementation of a set of rules carefully crafted not to interfere with political sovereignty and approved by Argentina's congress. Let's leave rhetoric and obstructing pride aside. The situation is too dire for that. We apologize to those we have offended --- here is another try at a problem and its solution that we take at the most serious level.

The problem of Argentina is far beyond a garden-variety liquidity crisis. The solution is not a temporary injection of resources alone. It must start with a clear sense of how to fix what comes next, the medium and long run. There is significant agreement on some of the key general ingredients of that structural reform: Improve incentives, represented by the need to reform an ill designed co-participation system, fight corruption and ensure property rights with no compromise, and remove a series of well known rigidities in Argentina's structure. Commit now and elect in 2003 the candidate that makes of these his or her trademark.

Despite the essential role of a long run strategy in any feasible plan, the real killer is the short run. Even if the right long run plan is agreed upon, it won't be enough to stop Argentina's free fall. There is no hope of finding a bottom, or even of implementing many of the urgent measures needed to restart the financial system until confidence is not regained. Foreign and, most importantly, Argentinean resources abroad must come back if there is a way out of this crisis. At this time, the flow is going the wrong way. There is no IMF money that can make up for this gap. It is beyond their means as well. Confidence must be regained quickly, and the sheer announcement of the sound long run strategy will not be enough – it has to be credible. Achieving the latter is hard for anybody with Argentina's record, more so for a transitional government regardless of how good its intentions might be.

Put bluntly, there are three broad short run options:

Option 1: *The chicken soup approach.* This is what is being tried and discussed now, both domestically and abroad. That is, a collection of minor remedies to some symptoms that have appeared in other, milder crises. Unfortunately, this is not a real option for Argentina today – it is simply waiting for the crisis to get a lot worse before acting decisively. Some politicians may favor this option, for it may save their skins or may feel that as of yet there is no broad based support for something more extreme. If the latter is true, although the recent polls suggest otherwise, the patriotic thing to do is to accelerate consensus on a real solution by leveraging on their leadership, rather than hide behind postponement. Argentineans must reject this non-option. The international financial institutions will not do it for them.

Option 2: *The standard cold-turkey approach.* There is no better way to build credibility about the implementation of a long run plan than starting it right away; even overshooting in the short run to make a clear statement. In many cases this is a sound strategy, and some aspects of it will have to take place in Argentina. But Argentina is already too sick to take this medicine. Yet, many important steps that do not require external assistance can be taken immediately. Anti-corruption campaign --- without mercy to tainted judges, congressmen, civil servants and others; yes. Reform of the tax and co-participation systems; yes. Protection of property rights and stabilization of the rules of the game; yes. Reactivation of the payment system and a scheme out of the "corralito;" yes. Other steps are simply too risky at this stage. It is difficult to believe that Argentina can reduce

its fiscal deficit quickly enough to fulfill the much needed credibility goal without triggering a social explosion --- any promise to such an adjustment is simply not credible. It is even harder to believe that the central bank can find a monetary policy contractionary enough, short of wiping out the peso, that can convince anybody that a nominal anchor has been found.

Option 3: The *imported credibility approach—the bridge*. If the problem is not one of lack of conviction in the sound long run strategy but one of insufficient trust, the cheapest way to go about it is to rent it. This principle is the source of our proposal. If Argentina wants to have access to sound monetary policy, have a well known international Central Banker run it under a tight set of rules agreed upon by Argentina and its advisers. If Argentina wants to build credibility on its fiscal soundness, promise a less front loaded adjustment than under option 2, but have an international monitor witnessing all the key transactions, perhaps even writing and receiving the large checks – make the check book public information, and post it right next to the agreement. Domestic lending will not restart until clear, permanent, and enforceable rules are put in place; bring an international regulator, perhaps somebody from the BIS could play the part. In all these areas Argentinean experts must take a very active role and be prepared to take the baton once, some years down the road, the intervention is no longer needed.

Let there be no illusion, even option 3 will come with costs and difficult times ahead. Anybody that claims otherwise is either dishonest or deeply confused. There has to be something positive – compliance with a strict program-- that foreign monitors can report to the rest of the world and Argentineans alike. There has to be some adjustment --- just not nearly as much as option 2 would entail or non-option 1 would eventually bring.

Option 3 would allow for some margin of error as well. This is important because getting out from as deep as Argentina is today will not be mistake free --- it is key to have some credibility-slack to recover from these errors. Going at it alone, even with a strong commitment, would be very risky as the same “honest” mistakes may be interpreted very differently by jittery investors. Why should Argentineans choose to navigate these risky waters when alternative routes are available? This is not the time for Argentinean politicians to show off --- the cost of failing on this risky bet would be absorbed by a population that has already endured a lot.

Using the opportunity to build institutions, and employing respected foreign experts to lay the foundations and ensure early and sustained success, lowers the economic and political costs of reconstruction and distinctly increases the chances. It is not a substitute for Duhalde and whoever follows him. In fact, it may be the only option for Duhalde to stay in power, and for the transition to the next one in charge to occur in a democratic and orderly environment. Of course politicians may squander it all again: Fake acceptance of a serious program only to use the additional resources and please themselves. But that will be harder because the public will have a more effective way of monitoring what is being done to their economic lives. Let us hope that given a permanent option out of this terrible crisis politicians will finally rise to the occasion. If not, the “escraches” will be well deserved.