Doubling Down on a Failed Approach: Argentina's IMF Programme, One Year Later

In July 2018, the International Monetary Fund (IMF) released the details of its loan agreement with Argentina, a programme which promised to "ensure that debt remains sustainable, reduce inflation, and foster growth and job creation, while reducing poverty."[1] The IMF proposed an orthodox programme, with a sizeable fiscal consolidation that was supposed to restore market confidence and fix Argentina's economic woes. One year later, the situation is not what the IMF projected: the economy is still in recession, unemployment is growing, inflation has not stabilized, debt sustainability has worsened, and poverty is soaring.

Given the IMF's proven track record of underestimating the negative impacts of austerity measures on the economy, this outcome is not surprising.[2] This is the IMF's largest loan programme, totalling about $56.4 billion, out of which $38.9 billion has been disbursed.[3]

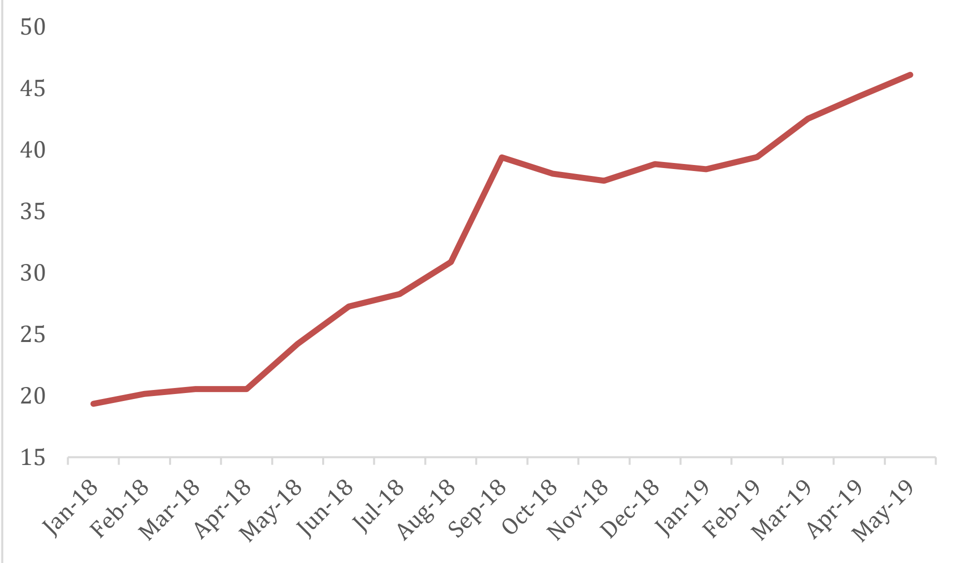
The currency crisis

After president Mauricio Macri took office at the end of 2015, he removed previous restrictions on capital flows and increased foreign borrowing, moves which fuelled the increase in Argentina's capital account deficit.[4] In early 2018, the gradual rise in US interest rates precipitated capital outflows from emerging markets, which precipitated Argentina's currency crisis and revealed its macroeconomic imbalances.

The collapse of the peso exacerbated inflationary pressures and increased the cost of repaying dollar denominated debt, worsening Argentina's balance of payments problems. Argentina's central bank stumbled in its response to the fall of the peso and despite significant monetary tightening and interventions in foreign exchange markets to defend the peso, the currency continued to slide.[5]

FIGURE 1

US Dollar to Argentine Peso Exchange Rate (Monthly Average)



Source: Banco Central de la República Argentina (BCRA).

Figure 1 illustrates the exchange rate between the US dollar and the Argentine peso. When Argentina turned to the IMF in May 2018, the peso had lost about 20 per cent of its January 2018 value against the dollar. By the end of 2018, it had lost over half of its value against the dollar, falling from 19.3 pesos per dollar in January 2018, to 38.9 pesos per dollar in December. In May 2019 the peso reached yet a new low, sliding to 46 pesos per dollar.

Given Argentina's increased reliance on debt denominated in dollars after 2016, the currency depreciation had a substantial impact on the debt burden. In 2018, the debt-to-GDP ratio of Argentina jumped by 23.6 percentage points, from 57.6 to 81.2 per cent of GDP, with most of this increase stemming from exchange rate depreciation.[6]

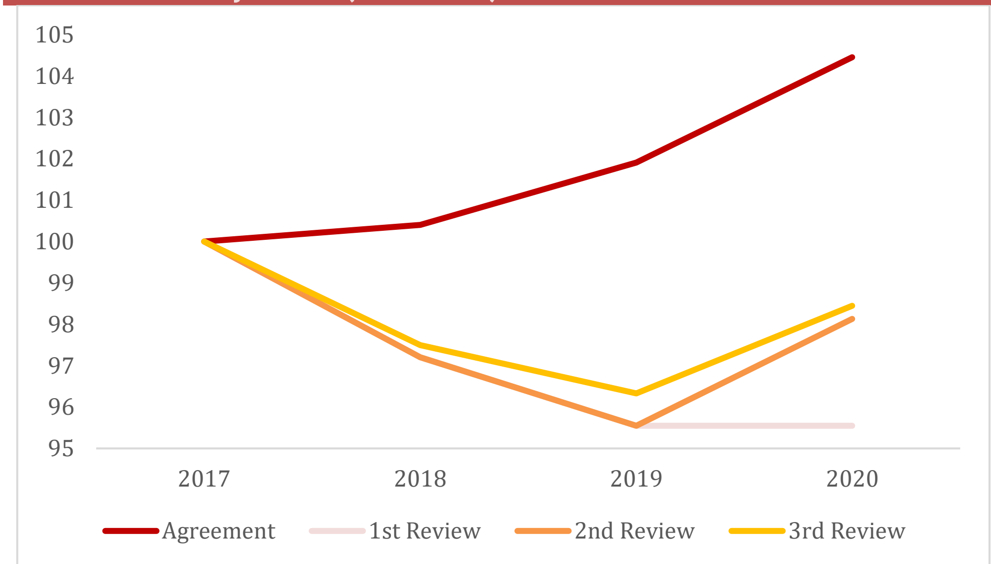
The IMF programme

The IMF approach to Argentina's problems was a sizeable fiscal adjustment, that the Fund claimed would restore market confidence and lead to an economic recovery. The assumption was that austerity would reduce borrowing and put Argentina's debt on a downwards path. The initial agreement was for a $50 billion loan, an amount that was increased to $56.3 billion after the first review of the programme.[7]

The programme relied on procyclical macroeconomic policies, that reduce spending and increase taxes during a recession, assuming they would have little negative impact on the economy. The programme initially called for achieving a balanced budget in 2020, a goal which was then accelerated to 2019. Argentina is now expected by the IMF to achieve a primary balance of zero for 2019, and a primary surplus of 1 per cent for 2020, up from a deficit of 2.8 per cent in 2018 The initial target for 2019 was a 1.3 per cent deficit., making the new targets a substantial fiscal adjustment.[8]

Despite initial projections assuming little to no impact on growth from austerity, this approach did not have the desired outcome. Argentina's economy went into recession and growth projections have been adjusted downwards significantly.

FIGURE 2
Real Growth Projections (2017 =100)



Source: IMF Stand-By Agreement, First Review, Second Review, Third Review, author's calculations.

Figure 2 illustrates the real growth index for Argentina starting in 2017 based on the projections from the initial Stand-By Agreement and each subsequent review of the agreement. Initially, the IMF projected that from 2018 to 2020, the Argentine economy would grow by almost 4.5 percent in real terms. These expectations were severely adjusted downwards after the first review, then slightly adjusted upwards following better than expected agricultural harvest.[9] However, the IMF still expects the economy of Argentina to be about 1.6 per cent smaller in 2020 than it was in 2017.

Overall, Argentina's outlook for this year is worse than what the Stand-by Agreement projected under an unlikely "adverse scenario" for the economy.

Table 1

Evolution of IMF Projections for Argentina from July 2018 to April 2019									
	Real GDP Growth			**Inflation**			**Public Debt (% of GDP)**		
	Baseline	Adverse	Current	Baseline	Adverse	Current	Baseline	Adverse	Current
2018	0.4	-1.3	-2.5	27	31.7	47.6	64.5	68.9	86.3
2019	1.5	0	-1.2	17	20.8	30.5	60.9	65.4	75.9
2020	2.5	1	2.2	13	15	21.2	57.4	60	69

Source: IMF Stand-By Agreement, First Review, Second Review, Third Review.

Table 1 shows the evolution of IMF projections for real GDP growth, inflation, and the debt ratio, including the baseline and adverse scenarios in the initial July 2018 agreement, along with the most recent projections from the third review in April 2019. The current projections are significantly worse than the predictions for an unlikely adverse scenario case. The economy shrank by 2.5 per cent in 2018 and is expected to shrink by another 1.2 per cent in 2019. While the IMF continues to project growth of 2.2 per cent for 2020, given the circumstances it is unlikely that this prediction will be accurate. The programme has also failed to subdue inflation, which reached almost 50 per cent in 2018. The IMF still expects inflation to fall over 2019 down to 30 per cent, however the most current estimates from the Argentine central bank suggest that this is extremely unlikely. In May, year-over-year inflation was estimated at almost 58 per cent.[10]

As the crisis worsened, the debt ratio hit 86.3 per cent of GDP in 2018 (from 57.1 per cent in 2017) and the IMF now expects the ratio to reach 75.9 per cent in 2019. It is important to note that the initial agreement stated that in the adverse scenario, the "debt remains sustainable but not with a high probability." This raises questions on the sustainability of the current debt burden, which is 17.4 per cent of GDP larger than the adverse scenario.

Another consequence of Argentina's worsening recession and shrinking economy is the government's inability to meet revenue targets. Reduced revenue has led to even sharper spending cuts in order to meet the loan condition of a balanced budget.

The initial agreement proposed spending cuts of 1.7 per cent in 2018 and 4.2 per cent in 2019. Initial measures included a reduction to the public wage bill of 0.2 per cent of GDP for 2018, and 0.3 per cent of GDP for 2019. A comparison between the proposed budget from the initial agreement, and the third review of the agreements reveals some of the additional spending cuts.

Table 2

Additional Spending Cuts as Per Cent of GDP			
	2018	2019	2020
Federal Social Assistance	(0.1)	(0.3)	(0.1)
Public Sector Wage Bill	(0.6)	(0.5)	(0.3)
Pensions	(1)	(1)	(0.7)
Transfers to provinces	(0.4)	(0.3)	(0.1)
Source: IMF Stand-By Agreement, Third Review, author's calculations.			

The additional spending reductions are shown in **Table 2**. Spending on public sector wages was cut by an additional 0.6 per cent of GDP in addition to the initial 0.2 reduction for 2018, and an additional 0.5 per cent on top of the initial 0.3 per cent for 2019. Federal social assistance spending was initially budgeted at 2.7 per cent of GDP for 2018, and 2019, and 2.4 per cent for 2020.[11] This was reduced in the programme's latest version to 2.6 per cent for 2018, and 2.4 per cent for 2019 and 2020. Spending on pensions decreased by 1 per cent of GDP in 2018 and 2019, and 0.7 per cent for 2020. At the same time transfers to provinces were also lowered as a per cent of GDP.

Incomes and poverty

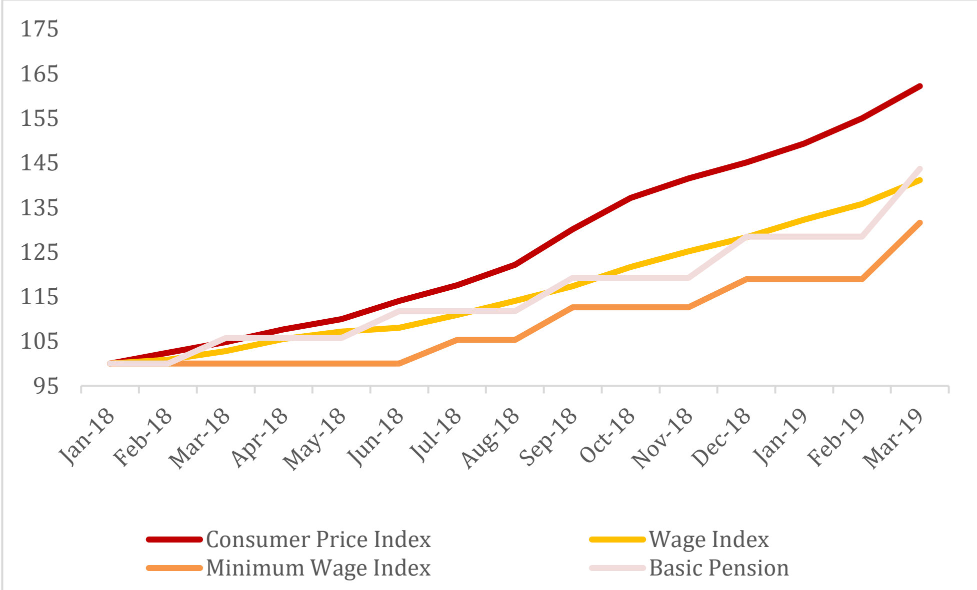
Persistent high inflation has led to an erosion of incomes and living standards, as wages and pensions have not kept up with the price increases.

The nominal growth in consumer prices, overall wages, minimum wages, and the basic pension are shown in **Figure 3**. Between January 2018 and March 2019, the consumer price index indicates that prices have grown by 62.2 points, while the overall wage index shows that average wages only grew by 41.1 points in the same period. The minimum wage grew nominally by 31.6 points, and the basic pension by 43.6 points. This translates into an average pay cut in real terms of 13 per cent for the average wage earner, and an almost 19 per cent cut for minimum wage earners. This real fall in incomes is holding back consumption and demand and slowing down the prospects of the recovery.

The worse than expected recession also led to higher unemployment rates. While initially the IMF predicted unemployment would reach 8.6 per cent in 2019, it now estimates an unemployment rate of 9.9 per cent for both 2019 and 2020.

FIGURE 3

Inflation and Incomes Index (January 2018 = 100)



Source: INDEC, MECON.

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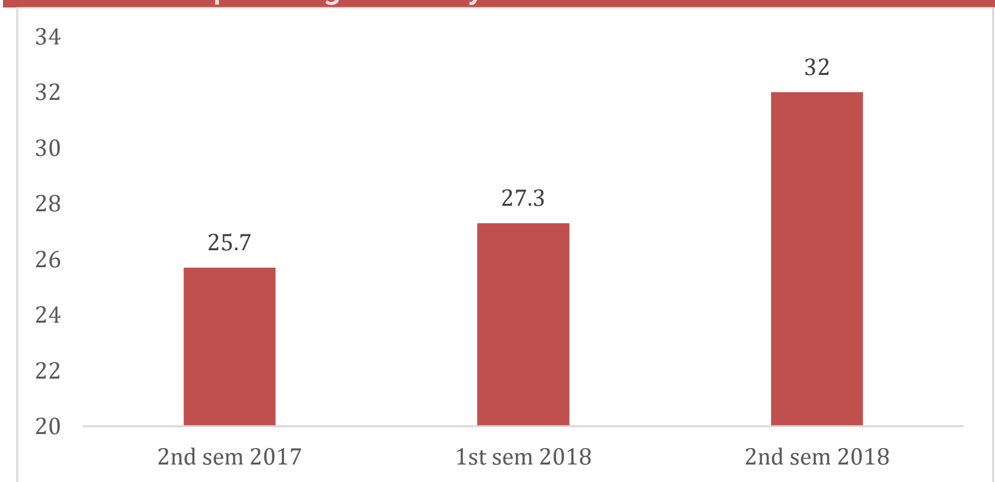
The IMF stated in the release of the agreement that “the authorities’ goal is to continue to reduce poverty rates throughout the course of the arrangement.” [12] Poverty has instead sharply increased.

FIGURE 4

Percent of People Living in Poverty



Source: INDEC.

As seen in **Figure 4**, the rate of people living in poverty has increased from 25.7 per cent at the end of 2017 to 32 per cent by the end of 2018. Since the programme has started in mid-2018, poverty has gone up by 4.7 percentage points.

Social assistance spending floor

To further the goal of protecting "the most vulnerable," this IMF agreement contained a binding spending floor that covered a selected set of social assistance programmes. The spending floor was fixed at a level that reflected the spending on those programmes prior to the worsening economic crisis, increasing poverty, and erosion of incomes. Outside of the selected programmes under the floor, the IMF directly called for cuts to what it considers "lower priority" social assistance.[13]

The social spending floor is set at 1.3 per cent of GDP, and initially covered a list of 4 social assistance programmes.[14] The 1.3 per cent of GDP was set based on spending level for those programmes prior to the crisis and includes an "adjustor" that allows for budget targets to be missed by 0.3 of GDP due to spending for the protected social assistance programmes. Overall federal social assistance spending had been around 2.7 per cent of GDP in 2018, a much higher amount than what is protected under the floor, even with the additional adjustor. The list of programmes under the floor was expanded in the latest review from the four initial programmes to now a total of nine. While this might seem like a positive development in terms of more programmes being protected, it also means that the same floor is divided amongst more programmes, which leaves room for possible cuts and moves the goalposts of protecting social assistance spending.

Conclusion

One year since the start of the IMF programme, it is clear it has failed to deliver on its promises. However, the IMF is doubling down on its approach of harsh austerity and pushing for the government to meet all its fiscal targets through additional cuts after revenue targets were not met.

As presidential elections approach in October, the government of Argentina led by Mauricio Macri, is attempting to smooth over some of the negative consequences of the policies adopted as part of the IMF agreement. Macri has re-introduced price controls in a bid to tame inflation, and increased trade tariffs in a bid to raise more revenue.[15] The government has also announced it would offer subsidized credit to consumers to boost sales of durable goods.[16] Despite criticizing similar policies in the past, the IMF has not directly commented on the measures introduced by Macri and has signalled its continued support for the current government.[17]

As Argentina's debt burden grows, the IMF is not adequately addressing concerns over the sustainability of Argentina's debt, which is worsened by the prolonged economic crisis. Argentina previously defaulted on its sovereign debt in 2002 after a disastrous IMF agreement wrecked the economy.[18] While circumstances are different now, the lack of IMF action on debt sustainability and the deleterious effects of the loan programme on the economy are a reminder of the last failed agreement with Argentina.[19]

References:
[1] IMF (2018a). Request for Stand-BY Arrangement
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[3] IMF (2019a). IMF Lending Arrangements as of May 31, 2019
[4] Guzman and Stigliz (2018). This is where Argentina's surprise crisis started
[5] A more detailed account can be found in Weisbrot and Merling (2018). Argentina's Deal with the IMF: Will "Expansionary Austerity" Work?
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[19] IMF IEO (2004). The IMF and Argentina, 1991–2001