Press Release: IMF's Independent Evaluation Office Announces Release of Report on the Role of the IMF in Argentina

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Independent Evaluation Office

of the International Monetary Fund

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The Independent Evaluation Office (IEO) of the International Monetary Fund (IMF) today released the report ***Evaluation of the Role of the IMF in Argentina, 1991-2001***.

The Argentine crisis of 2000-02 was among the most severe of recent currency crises. In December 2001, Argentina defaulted on its sovereign debt and soon afterwards abandoned the convertibility regime, under which the peso had been pegged at parity with the U.S. dollar since 1991. The crisis had a devastating economic and social impact, causing many observers to question the role played by the IMF over the preceding decade when it was almost continuously engaged in the country through five successive financing arrangements.

The report examines the role of the IMF in Argentina during 1991-2001, taking advantage of the IEO's unique access to internal documents, in order to draw lessons for the IMF in improving both its surveillance and crisis management capabilities in future. In accordance with the IEO's general terms of reference, we do not assess issues that have a direct bearing on ongoing operations. Consequently, the report does not discuss developments beyond the first few days of 2002. As with all IEO reports, the version being made public is identical to the one submitted to management and the Executive Board. The report has not been changed in response to management's comments or the views expressed at the Board. Instead, following standard IEO practice, it is being released along with separate management and staff comments and the summing up of the Board discussion.

Major findings:

The crisis resulted from the failure of Argentine policy makers to take necessary corrective measures sufficiently early. IMF surveillance failed to highlight the growing vulnerabilities in the authorities' choice of policies and the IMF erred by supporting inadequate policies too long. By 2000, there were concerns about exchange rate and debt sustainability, but there was no easy solution. Recognizing the large costs of exit, the IMF supported Argentina's efforts to preserve the exchange rate regime. This support was justifiable up to January 2001 because large financial support, combined with strong policy corrections, had some chance of success. However, subsequent disbursements, made despite repeated policy inadequacies, only postponed the fundamental resolution of the crisis. In retrospect, the resources used in an attempt to preserve the peg could have been better used to mitigate some of the inevitable costs of exit.

- **During the precrisis period**, the IMF correctly recognized fiscal discipline and structural reform, labor market reform in particular, as essential to the viability of the convertibility regime. However, surveillance underestimated the vulnerability that could arise from the steady increase in public debt, when much of it was dollar-denominated and externally held, and did not consider exit strategies when it became evident that meaningful progress in structural reform was not forthcoming. Long-standing political obstacles proved formidable, but neither did the IMF use the available tools effectively. Conditionality was weak, and Argentina's failure to comply with it was repeatedly accommodated. The result was that the IMF remained engaged in a program relationship with Argentina too long, when the policies being supported were inadequate.
- **From late 2000,** the IMF increased its commitment of resources to as much as US$22 billion. The strategy viewed any exchange rate or debt sustainability problem as manageable with strong action on the fiscal and structural fronts, and may well have worked if the underlying assumptions had materialized and the program had been impeccably executed. The authorities, however, proved unable to implement the policies as agreed, and the successive resignations of two Ministers of Economy in March 2001 shattered market confidence. Then, the new Minister of Economy began to take a series of controversial and market-shaking measures. Yet, the IMF, having no effective contingency plan, continued to disburse and augment funds in support of the existing policy framework.
- By mid-2001, it should have been clear that the initial strategy had failed and that Argentina's exchange rate and public debt could not be considered sustainable. However, the IMF did not press the authorities for a fundamental change in the policy regime and, in **December 2001**, effectively cut off its financial support to Argentina. The decision to call the program off-track was fully justified under the circumstances, but the way in which it was done meant that the IMF was unable to provide much help as the crisis unraveled. Exit from the peg would have been very costly regardless of when it was made, but an earlier shift in the IMF's strategy could have mitigated some of the costs because Argentina's economic health would have deteriorated that much less and more resources would have been available to moderate the inevitably painful transition process.
- The Argentine experience reveals weaknesses in **the IMF's decision-making process**. First, contingency planning was insufficient. Second, from March 2001 on, the IMF accepted a less cooperative relationship with the authorities, who often took multiple policy initiatives without prior consultation. Third, little attention was paid to the risks of giving the authorities the benefit of the doubt beyond the point where sustainability was clearly in question. Fourth, the Executive Board did not fully perform its oversight responsibility, exploring the potential tradeoffs between alternative options.

Recommendations:

A great deal of learning has already taken place within the IMF since the Argentine crisis. New guidelines have been issued, or are being discussed, to incorporate that learning into policies and operational procedures. The report draws ten lessons, from which it presents six sets of recommendations in order to strengthen the initiatives already being taken. The main points are as follows:

- IMF surveillance needs to be strengthened further, by making medium-term exchange rate and debt sustainability the core focus. To fulfill these objectives, the IMF needs to improve tools for assessing the equilibrium real exchange rate, examine debt profiles from the perspective of "debt intolerance," and take a longer-term perspective on vulnerabilities that could surface over the medium term. Systematic discussion of exchange rate policy must become a routine exercise on the basis of candid staff analysis.

- The IMF should have a contingency strategy from the outset of a crisis, including "stop-loss rules"- a set of criteria to determine if the initial strategy is working and to guide the decision on when a change in approach is needed. Where the sustainability of debt or the exchange rate is in question, the IMF should indicate that its support is conditional upon a meaningful shift in the country's policy. High priority should be given to defining the role of the IMF when a country seeking exceptional access has a solvency problem.
- The IMF should refrain from entering a program relationship with a country when there is no immediate balance of payments need and there are serious political obstacles to needed policy adjustment or reform. Exceptional access should entail a presumption of close cooperation, and special incentives to forge such close collaboration should be adopted, including mandatory disclosure to the Board of any critical issue or information that the authorities refuse to discuss with (or disclose to) staff or management.
- In order to strengthen the role of the Executive Board, procedures should be adopted to encourage: (i) effective Board oversight of decisions under management's purview; (ii) provision of candid and full information to the Board on all relevant issues; and (iii) open exchanges of views between management and the Board on all topics, including the most sensitive ones. These initiatives will be successful only insofar as IMF shareholders uphold the role of the Board as the prime locus of decision-making.

The report was discussed by the IMF's Executive Board on July 26, 2004. The Board welcomed the report and broadly endorsed the thrust of its findings, lessons and recommendations. It emphasized that it would be important to make further progress in incorporating these lessons into the IMF's operations and decision making process. The report, along with IMF management and staff responses and the summing up of the Board discussion are available on the IEO's website at **www.ieo-imf.org**.

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