

The challenges of Argentina's debt renegotiation

By José Antonio Ocampo

February 26, 2020 – *Project Syndicate*

By affirming that Argentina's public-sector debt is unsustainable, the International Monetary Fund has taken a critical step toward resolving the country's long-running crisis. Moving forward, one hopes that the Fund will realize its own role in the latest crisis and follow its own advice on when to pursue capital-market liberalization.

Argentina has just passed a critical juncture with respect to its debt. The International Monetary Fund's mission to the country has affirmed that the public-sector debt is unsustainable, as President Alberto Fernández and his minister of the economy, Martín Guzmán, a debt expert, have been pointing out. According to the IMF, "The primary surplus that would be needed to reduce public debt and gross financing needs to levels consistent with manageable rollover risk and satisfactory potential growth is not economically nor politically feasible."

The current state of affairs reflects the massive accumulation of debt under former President Mauricio Macri's administration, which increased the central government debt from \$241 billion to \$321 billion during its first two years. That build-up was accompanied by a strong appreciation of the peso but only weak economic growth. It was soon followed by a recession, high inflation, and sharp currency depreciation. Owing to this combination of increased debt and a sharp fall in the dollar value of GDP, Argentina's central government debt ratio skyrocketed to over 90% of GDP in 2019.

The current debt crisis also reflects a broader loss of confidence among both external creditors and domestic agents. Over the past two years, this crisis of confidence has caused a sudden stop in external financing and almost \$50 billion in capital flight. That figure is not far off from the \$44 billion that the country has drawn from the \$50 billion IMF loan that the

Fund approved in June 2018 and raised to \$57 billion the following September.

Needless to say, the fact that the Argentinian economy collapsed in the midst of an IMF program should lead to some soul-searching. In retrospect, the Fund clearly made a major mistake by backing the massive liberalization of capital flows that the Macri administration undertook in 2016 and 2017. That approach led to a boom-bust cycle of external financing: massive capital inflows were followed by the massive capital outflows that forced the Macri administration to reintroduce harsh capital controls.

It is worth remembering that in 2012, the IMF adopted the "Institutional View on Capital Flows," which favors a cautious approach to such liberalization and emphasizes the need to maintain strong macroprudential policies, including regulations of capital inflows. Indeed, this framework was particularly relevant for Argentina, given its history of external-financing boom-bust cycles. Once again, the country experienced a boom that brought hardly any benefits, followed by a bust that inflicted significant pain.

Looking ahead, the most important immediate task is to ensure a sustainable and orderly resolution of the debt crisis. As the IMF said in its latest statement, a "meaningful contribution from private creditors is required to help restore debt sustainability with high probability." This will require "a collaborative process of engagement with private creditors to maximize their participation in the debt operation."

At the heart of the negotiations must be a conservative program that guarantees a level of debt service compatible with economic recovery and exchange-rate stabilization, which is also essential to reduce inflation. Creditors would benefit from this scenario, because it would shore up the country's capacity to service its debt, thereby avoiding another round of negotiations and creating a positive environment for future business with Argentina.

The question, then, is what conditions will enable such a program to succeed. Changing the maturities and extending some level of debt relief during the recovery period are both essential. The negotiators will have to decide on a combination of interest-rate reduction and haircuts for creditors. However, too much emphasis on haircuts could create a climate of confrontation in which Argentinian bonds shift into the hands of speculative holders. This could cause severe headaches, as Argentina learned in 2012 when US District Court Judge Thomas Griesa issued his infamous decision on the country's debt.

The Fernández administration has already made a show of good faith by not defaulting when it took over in December 2019; and the

Province of Buenos Aires did likewise by making punctual payments on its debt a few weeks ago. While several of the province's creditors had expressed a willingness to consider postponing part of the amortizations for a few months, other major creditors were less keen on such collaboration. In any case, Guzmán and the creditors must now work together to find a cooperative, holistic, and sustainable solution.

For its part, the IMF must transform its loan program from a shorter-term stand-by agreement into an extended facility next year. And, in the meantime, the Fund must serve as a strong partner to the Argentinian government during the negotiations with creditors, in order to ensure a sustainable debt.

One thing is abundantly clear: Argentina must avoid another premature liberalization of capital flows. Unlike in the period leading up to the current crisis, the IMF's Institutional View on Capital Flows should now be fully applied.

José Antonio Ocampo is a professor at Columbia University and Chair of the UN's Committee for Development Policy. He was Minister of Finance of Colombia and United Nations Under-Secretary-General for Economic and Social Affairs.