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Argentina and the International Monetary Fund (IMF) will soon begin negotiations about renewed aid to Argentina. This is a mistake, a backward step to the time of false promises and the funding of inept governments. The most constructive step the IMF could take would provide for renegotiation of Argentina's international debt, leaving Argentina to solve its political problems when it can.

In its eight months in office, the current Argentine government has done little or nothing to alleviate its deep crisis and much to make it worse. Unemployment is near 25%. More than a million people have emigrated, a sure sign that they have given up hope of a return to stability. Forty percent of those who remain are impoverished. Inflation soared following devaluation and rapid money creation. Although 40 percent of daily consumer purchases are cash transactions, the government restricted access to money, sharply limiting these transactions.

In Argentina last week, Professor Joseph Stiglitz speculated that the IMF punished Argentina because it defaulted. This is nonsense. The government has not made the reforms needed for recovery. The previous government wrecked the banking system. Devaluation strengthened the export sector, so the government increased export taxes reducing exports. The courts gave people who sued the right to withdraw their bank deposits, so the government threatened to replace the judges to prevent withdrawals. It wasted scarce foreign exchange managing its exchange rate instead of letting it fall to a market level.

The International Monetary Fund (IMF) has shown remarkable calm compared to its past behavior. Aside from extending the term of some loans that Argentina could not pay, it has not offered any new money. Unfortunately, this policy appears to be ending. The IMF seems eager to reach an agreement and send more money. The signs are clear. The IMF sent a mission to negotiate a new loan agreement, and separately it sent four former central bankers (the wise men) to appraise conditions and recommend a monetary framework for non-inflationary growth. The
wise men made an intriguing statement at the end of their report. They said that if Argentina had credible policies, it would not be in crisis.

Argentina's main problem for decades has been a political system that can not maintain credible, pro-growth, non-inflationary policies. It has not kept promises to the IMF and other international lenders. Without political reform, there is little prospect that new promises will be kept.

Instead of negotiating another loan in exchange for promises, the IMF should withdraw from Argentine domestic policy. Political reform would come faster, if it comes at all, once Argentineans know that they cannot expect any assistance until reforms are implemented, not just promised. These reforms should be part of an Argentine plan to establish a political system that is responsive, transparent, open, honest, and capable of solving economic and social problems, as responsible governments elsewhere do.

The IMF cannot solve Argentina's problems. Success requires political support within the country. Argentina has shown that reform lacks support.

Banking reform is an example. The government recently offered to exchange blocked deposits for bonds payable in five or ten years. Few accepted this voluntary exchange. The IMF has proposed to convert the rejected voluntary exchange plan into a mandatory plan. Is this the way to teach the virtues of the market place and the rule of law? Does the IMF encourage democratic government by forcing changes that the public rejected overwhelmingly?

Argentines have shown what they prefer. They go to the trouble of getting court orders to get their deposits out of the banks. They immediately exchange their pesos for dollars, not the promises of a discredited government.

The IMF can help Argentina by supporting an Argentine effort to settle its outstanding debt to foreigners, about $45 billion dollars at face value and worth about $9 billion dollars at current prices. As Adam Lerrick and I proposed earlier, Argentina should now offer to negotiate an exchange into new debt. Its initial offer would be about 20 cents on the dollar, the current (illiquid) market price, supported by its increased export earnings. This would allow holders to liquidate their holdings and rebalance their portfolios.

The IMF can assist by offering to buy the debt for cash at 15 cents while the exchange offer remains outstanding. The total cost to the IMF in the worse possible case would be $6.8 billion, if everyone took cash. This is far less than the amount of the loans the IMF will make if
it continues on its current path. By offering a floor of support, the IMF would make the now illiquid bonds tradable and give an incentive for the market to find a solution.

The IMF will have contributed to a solution of the international part of the problem. It should leave the rest to Argentina. Freed of its default, and with a much smaller debt, Argentina could borrow again. When it has a political system that makes wise choices, it can begin to resolve its banking, financial, and fiscal problems.