The 14th Economic International Conference: Strategies and Development Policies of Territories: International, Country, Region, City, Location Challenges | May 10-11, 2018 | Stefan cel Mare University of Suceava, Romania

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The Strategy of International Monetary Fund in the Recovery of the Post-Crisis Economy in Latin America

Daniela Mihaela NEAMȚU¹

Abstract

The IMF's past experience in Latin America is far from promising. The failure of the Argentinian economic program in 2001 was a strong blow to the International Monetary Fund (IMF), namely rescue policies and their effectiveness, diminishing the institution's support in both developing and developed countries. Our main concern is how one country deals with the policies proposed by the IMF and the degree of government freedom. This paper is an attempt to assess how much a country needs the IMF. Argentina's and Brazil's recovery experience following the devaluation of the national currency provides an interesting case of analysis. Following the 1999 currency devaluation, Brazil pursued a closely monitored economic policy supported by the IMF, while Argentina, after the 2001-2002 crisis, pursued a more independent policy that in many cases opposed the IMF's recommendation. This paper compares the performances of both countries, as well as the benefits of pursuing or not the IMF's "recipe" to get out of a foreigner that could come from the balance of payments deficit. As we can see, pursuing the "recipe" of the IMF does not ensure either success or failure. This paper compares the experience of both countries with which it has the best strategy for recovery. Economic performance shows us that both countries have come back in a similar way, highlighting the need for the IMF to engage in recovery.

Keywords:

GDP; financial crisis; economic growth; tax account; inflation.

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1. Financial reorganization after the crisis in Argentina and Brazil

In the late 1990s and early 2000s, Brazil and Argentina went through economic crises and monetary devaluation. Both countries had fixed exchange rate regimes, even if the Convertibility program implied a high degree of economic and political compromise over the fixed exchange rate. Finally, the inconsistencies of these regimes, the contagion from the Russian and Korean financial crises, and the inability to generate economic growth forced a monetary devaluation and abandonment of such policies. Even though the economic crisis was severe in both countries, the Brazilian economy managed to respond better to monetary devaluation, while the Argentine economy suffered the worst economic depression in its history (*Table 1 and Table 2*). In Brazil, the economy stopped in 1998 and 1999 (close to zero GDP growth), but quickly recovered after monetary devaluation. Argentina, on the other hand, went through a deep recession from 1999 to 2001, but the devaluation of the currency could not stop the economic disaster. As a result, the economy decreased by 15.2% between 1999-2002. As the data show, the impact of the economic crisis and monetary devaluation was stronger in Argentina than in Brazil.

Many studies have addressed the causes of the economic crisis and the weaknesses of economic patterns in each country. Even though the debate is far from being closed, this paper focuses on the consequences of the crisis and the strategies that both countries have followed in order to resume economic growth.

Table 1. Brazilian economic indicators

An example of a column heading	Real GDP growth	GDP per capita, PPP US%	Inflation rate	Exchange rate	Investments % of GDP	Debts % of GDP	Exports % of GDP	Imports % of GDP	Trade % of GDP
1990	-3,1	6686,1	2947,7	0,0	20,4	25,9	8,2	7,0	15,2
1991	1,5	6892,0	432,8	0,0	19,7	29,7	8,7	7,9	16,6
1992	-0,5	6898,7	951,6	0,0	19,1	33,0	10,9	8,4	19,3
1993	4,7	7271,5	1928,0	0,0	20,8	32,8	10,5	9,1	19,6
1994	5,3	7696,4	2075,9	0,7	24,2	27,9	9,7	9,7	19,3
1995	4,4	8073,0	66,0	0,9	19,9	22,8	7,4	9,3	16,6
1996	2,2	8268,5	15,8	1,0	17,3	23,4	6,7	8,9	15,6
1997	3,4	8558,9	6,9	1,1	17,8	24,5	7,0	9,6	16,6
1998	0,3	8547,2	3,2	1,2	18,2	30,7	7,0	9,4	16,4
1999	0,5	8588,0	4,9	1,8	17,4	45,7	9,6	11,4	21,0
2000	4,1	9012,8	7,0	1,8	18,9	65,6	10,2	12,5	22,7

An example of a column heading	Real GDP growth	GDP per capita, PPP US%	Inflation rate	Exchange rate	Investments % of GDP	Debts % of GDP	Exports % of GDP	Imports % of GDP	Trade % of GDP
2001	1,4	9216,8	6,8	2,3	18,7	70,1	12,4	14,6	26,9
2002	3,1	9515,5	8,5	2,9	17,4	78,8	14,2	13,4	27,6
2003	1,1	9690,6	14,7	3,1	16,9	73,8	15,2	13,0	28,1
2004	5,8	10401,9	6,6	2,9	17,9	70,1	16,6	13,1	29,7
2005	3,2	10951,3	6,9	2,4	17,2	68,6	15,2	11,8	27,1
2006	4,0	11604,9	4,2	2,2	17,8	65,8	14,4	11,7	26,0
2007	6,1	12503,6	3,6	1,9	19,8	63,7	13,3	12,0	25,3
2008	5,1	13262,8	5,7	1,8	21,6	61,9	13,5	13,7	27,3
2009	-0,1	13215,4	4,9	2,0	18,8	64,9	10,9	11,3	22,1
2010	7,5	14245,0	5,0	1,8	21,8	63,0	10,7	11,8	22,5
2011	4,0	14973,1	6,6	1,7	21,8	61,2	11,5	12,2	23,7
2012	1,9	15396,6	5,4	2,0	21,4	62,2	11,7	13,1	24,8
2013	3,0	15968,3	6,2	2,2	22,0	60,2	11,6	13,9	25,6
2014	0,5	16160,4	6,3	2,4	21,0	62,3	11,0	13,7	24,7
2015	-3,8	15617,3	9,2	3,3	19,1	72,5	12,9	14,1	27,0
2016	-3,6	15123,9	8,7	3,5	17,5	78,3	12,5	12,1	24,6

Source: World Development Indicators (WDI), World Bank, www.worldbank.org, International Monetary Fund, World Economic Outlook Database, April 2017, www.imf.org.

Table 2. Argentinian economic indicators

An example of a column heading	Real GDP growth	GDP per capita, PPP US%	Inflation rate	Exchange rate	Investments % of GDP	Debts % of GDP	Exports % of GDP	Imports % of GDP	Trade % of GDP
1990	-2,4	6990,6	2314,0	0,5	11,7	44,0	10,4	4,6	15,0
1991	12,7	8024,6	171,7	1,0	12,3	34,5	7,7	6,1	13,8
1992	11,9	9061,6	24,9	1,0	13,9	25,7	6,6	8,1	14,7
1993	5,9	9694,0	10,6	1,0	17,8	27,7	6,9	9,3	16,2
1994	5,8	10342,5	4,2	1,0	18,1	29,3	7,5	10,6	18,1
1995	-2,8	10129,8	3,4	1,0	16,9	31,7	9,7	10,1	19,8
1996	5,5	10754,2	0,2	1,0	17,9	33,6	10,4	11,1	21,5
1997	8,1	11688,7	0,5	1,0	19,0	32,7	10,6	12,8	23,3
1998	3,9	12132,5	0,9	1,0	19,1	35,2	10,4	12,9	23,3
1999	-3,4	11769,1	-1,2	1,0	16,0	40,1	9,8	11,6	21,3
2000	-0,8	11810,1	-0,9	1,0	15,8	42,1	11,0	11,6	22,6
2001	-4,4	11419,1	-1,1	1,0	14,0	49,4	11,6	10,3	21,9
2002	-10,9	10217,3	25,9	3,1	10,3	152,2	28,4	13,4	41,8
2003	8,8	11217,6	13,4	2,9	13,3	128,7	25,9	14,7	40,6
2004	9,0	12430,7	4,4	2,9	17,6	117,3	23,8	16,8	40,7
2005	8,9	13817,7	9,6	2,9	18,9	79,2	23,2	17,3	40,6
2006	8,0	15227,5	10,9	3,1	18,7	69,8	23,0	17,4	40,4
2007	9,0	16865,5	8,8	3,1	20,1	61,0	22,7	18,3	40,9
2008	4,1	17711,4	8,6	3,1	19,6	52,6	22,1	18,3	40,4

An example of a column heading	Real GDP growth	GDP per capita, PPP US%	Inflation rate	Exchange rate	Investments % of GDP	Debts % of GDP	Exports % of GDP	Imports % of GDP	Trade % of GDP
2009	-5,9	16618,1	6,3	3,7	16,1	53,9	19,6	14,5	34,1
2010	10,1	18333,5	10,8	3,9	17,7	42,0	18,9	16,0	35,0
2011	6,0	19629,4	9,5	4,1	18,4	37,5	18,4	16,8	35,2
2012	-1,0	19579,0	10,0	4,5	16,5	38,9	16,2	14,3	30,5
2013	2,4	20161,5	10,6	5,5	17,3	41,7	14,6	14,7	29,3
2014	-2,5	19762,9	n/a	8,1	17,3	43,6	14,4	14,0	28,4
2015	2,6	20340,3	n/a	9,2	16,9	56,0	11,0	11,8	22,9
2016	-2,2	19939,9	n/a	14,8	15,4	54,2	12,8	13,5	26,3

Source: World Development Indicators (WDI), World Bank, www.worldbank.org, International Monetary Fund, World Economic Outlook Database, April 2017, www.imf.org.

2. Post-crisis economic models in Brazil and Argentina

Following the crisis, the Brazilian economy faced a dilemma of economic policy. Many commentators thought the government would revert to the old irresponsible monetary policy to finance budget deficits [1, p.1]. However, management of currency devaluation allowed the economy to demonstrate a rapid economic recovery with a low inflation rate and a smooth transition to a flexible exchange rate. Monetary and fiscal constraints helped the economy to transition and stabilize just one year after currency devaluation [2, p.3]. The government has pursued a policy of dialogue and collaboration with the IMF, while trying to adapt to the social requirements in their constituencies. Economic policy followed a pattern of floating exchange rates and consistent monetary and fiscal policies that quickly reduced confidence in the economy [3, p.12]. The result has led to economic growth and a higher predictability of government policy (*Table 1*). Investors have changed their pre-election vision of Lula and realized that his government will not change the economic model for the Brazilian economy.

Social policies have been more difficult to implement because the Orthodox economic model has limited the ability to pursue dramatic changes in social resources or income distribution. *Figure 1* shows that total spending as a percentage of GDP has not changed compared to previous government levels.

Source: own data according to Euromonitor 2006.

Figure 1. Total social expenses.

In 2006, the government faced the challenge of a new presidential election and the need for Lula to improve its chances of being re-elected [4, p. 17]. The flexible exchange rate led to the appreciation of the Brazilian real (BRL) against the US dollar (USD), which reduced the competitiveness of Brazilian exports. The economy has slowed, and the uncertainty of the elections has sparked anxiety amongst investors. On the political front, Lula's government tried to increase popularity by cancelling all debts with the IMF, a decision that Argentina quickly followed [4, p. 7].

Argentina

Argentina's recession was far more severe than in Brazil (*Table 2*). The collapse of the financial and banking system at the end of 2001 led to an unprecedented political crisis in which five presidents were appointed and resigned within a ten-day period. At the beginning of 2002, the provisional government declared inability to pay external debts, devaluation of the peso and change of all contracts in the economy according to the new reality of the country. Managing the crisis has not been previously planned and in many cases has been a desperate attempt to maintain a certain stability amid the general economic chaos. Economic activity stopped and GDP fell into a recession that seemed never to end (*Table 2*). The government has been very close to hyperinflation in trying to control fiscal and monetary policies, and the IMF has decided not to help the country in resolving the crisis. After one year of effort, the economy stabilized and economic activity began to

show signs of recovery. The government was unable to pay the debt, the banking system was bankrupt, the contracts with the privatized companies were suspended, and the economy only showed signs of recovery. The government followed a monetary policy focused on supporting the exchange rate to three pesos per US dollar to maintain the competitiveness of domestic industry and agricultural exports (*Table 2*). Export revenue was quickly generated by the Central Bank, which led to an increase in domestic demand. As a result, the economy started to recover and quickly showed signs of improvement (*Table 2*). Inflationary pressures were too low, given the low level of industrial capacity utilization and high unemployment rates. As regards the tax sector, economic activity has increased resources and implicitly allowed the government to save resources and exert fiscal surpluses. This economic pattern continued throughout 2005 and 2006, while the IMF recommended a more flexible exchange rate and an immediate agreement with the debt holders. Because of the opposite view, the government has decided to close all channels of communication with the IMF and pursue a more independent economic policy [5, p. 2].

At the beginning of 2005, the government offered the borrowers a "take it or leave it" offer for defamatory debt, leading to the largest reduction in sovereign debt in history (Argentina Country Report, February 2006, p. The IMF did not support this program, but borrowers, without any other option, have accepted the agreement. Debt restructuring allowed the government to return to the financial markets (*Figure 2*). The fiscal situation was kept under control, and favourable international conditions, high export prices and low interest rates allowed sustained economic growth (*Table 2*).

In order to minimize criticism and opposition from the IMF, the government followed the example of Brazil and cancelled its debt to the IMF using the reserves of the Central Bank. The Central Bank continued to sterilize the influx of US dollars in the economy, allowing the country to maintain an exchange rate of nearly three pesos on the US dollar and outlining domestic demand. However, the interest rate on short-term liabilities increased, both due to the debt volume and the rise in US interest rates. This policy generates a cost in terms of short-term bonds that the Central Bank has to issue to pursue its policy [5, p. 9]. The investment remained Achilles' heel for this economic model because price control, contractual and judicial uncertainty, and heterodox policies do not promote too much investment beyond the real boom of the state and public works. However, the policy of confronting the IMF has offered the government, despite future challenges, political and economic benefits.

3. Analysis of economic performance after the crisis

In order to assess the benefits of measuring the support of the IMF during the economic crisis, this chapter compares the performance of the main economic indicators for Argentina and Brazil. Under the policies described above, Brazil has followed a model IMF-friendly policy with a floating exchange rate, with the payment of debt based on adequate fiscal and monetary policies, while Argentina has pursued policies in direct opposition to the IMF and the international financial community through default, currency exchange control and market control, sterilization of currency exchange, use of controls to stop inflation, but maintaining a surplus on tax accounts.[6]

International markets have responded to differences in economic crises in both countries (*Figure 2*). Although the country's high leap in Brazil due to the devaluation in 1999 meant a leap of more than 500 basis points, it seems to be small compared to the jump of more than 6,000,000 base points in Argentina in June 2001 until June 2002. The Brazilian economy followed a high jump in 2002, fuelled by Argentina's fear of contagion and the possibility of Lula's election. However, the country's risk declined sharply by the end of 2002 and early 2003, as the markets realized that Lula's policies were in line with the sustainability of the economy and the Argentine crisis was limited to the domestic market. Finally, in 2005, Argentina returned to international markets, and country risk fell substantially, as the government came out of default and began paying interest on new bonds.

Source: own data according to Argentina's Ministry of Economy.

Figure 2. Country risk.

In terms of economic growth, the performance was quite different. The effect of monetary devaluation on the Brazilian economy was a slowdown in the economy, while the Argentine crisis caused a fall in real GDP of 15.2% (1998-2002). However, Argentina recorded a strong recovery, with an increase of 32.9% between 2002 and 2006, while Brazil increased by 18.0% over the same period. Overall, the Brazilian economy grew by 43.4% between 1997 and 2016, while the Argentine economy reached a 41.4% growth rate. As a result, some of the explanations for the amazing performance of the Argentine economy in recent years can be explained by the strong negative effect of the crisis on the economy. This negative effect is reflected in GDP per capita, measured in US dollars. In Argentina, GDP per capita fell by 2.8% between 1997-2004, while in Brazil it grew by 4.9% over the same period (*Figure 3*).

Source: World Development Indicators (WDI) own data, World Bank, www.worldbank.org.

Figure 3. GDP per capita index.

Monetary devaluation led to a nominal exchange rate adjustment in Brazil, while in Argentina drastically changed relative prices (*Figure 4*). This difference in the effects of monetary devaluation is reflected in the sharp changes in Argentina's trade balance (*Figure 5*). The devalued cumulative recession has increased the trade surplus from 1.3% of GDP in 2001 to 15.0% in 2002. This surplus has fallen in recent years due to economic growth but is still higher than in Brazil, largely due to differences on the foreign exchange policies applied by each country. [7]

Source: own data according to IMF financial and monetary statistics, www.imf.org.

Figure 4. Nominal exchange rate per USD.

Source: World Development Indicators (WDI) own data, World Bank, www.worldbank.org.

Figure 5. Trade balance.

Argentina had a similar effect on the share of total debt in GDP, which rose sharply to 147% in 2002 and fell in 2005 as a result of the default. In Brazil, the debt burden rose in 1999 as a result of the devaluation of the domestic currency but did not escape control, fluctuating with exchange rate fluctuations.

In the case of investment, Argentina suffered a strong benchmark with low investment levels in 2000-2003. This real investment deficit was

not complemented by foreign direct investment inflows, which drained in 2001. While Argentina had a larger share of capital flow in GDP in the 1990s, Brazil exceeded these levels between 2000 and 2004 (*Figure 6*). Moreover, the fall in capital flows to Argentina is more visible when considering the value of US dollar investment (*Figure 7*).

Source: World Development Indicators (WDI) own data, World Bank.

Figure 6. Foreign direct investments.

Source: World Development Indicators (WDI) own data, World Bank, www.worldbank.org.

Figure 7. Direct foreign investments.

Inflation and exchange rate were kept under control in both countries, although Argentina had problems because its monetary policy was devoted to exchange rate control. Total average inflation after the 1999 to 2006 monetary devaluation was 52.3% for Brazil and 65.7% for Argentina over the same period. However, Argentina recorded an average inflation rate of 73.5% over the period 2002-2006, which increased in the last quarters, reaching the threshold of 126.9% in 2014. Consequently, the government introduced price controls and other measures to support prices at low levels. In the short run, price controls have proven useful in maintaining inflation, but the medium-term outcome, when controls should be lifted, is uncertain (*Figure 8*).

Source: Own data according to FRED Economic Data, [8].

Figure 8. Price indicator.

The budget surplus has changed drastically after the monetary devaluation. Both countries have passed from deficits to surplus, improving their fiscal situation. In the case of Argentina, debt failure, which allowed the government to avoid paying interest for more than three years, helped sustain a budget surplus (*Figure 9*).

Source: www.imf.org [9]

Figure no. 9 Budget surplus.

As for unemployment, there was no change in Brazil, while in Argentina the unemployment rate rose sharply (*Figure 10*). However, rapid economic recovery has contributed to lowering the unemployment rate to similar levels to Brazil.

Source: own data according to IMF financial and monetary statistics, www.imf.org [9]

Figure 10. Unemployment rate.

4. Conclusions

Argentina's fiscal policy could have been more sustainable if the convertibility regime had not been in place. Moreover, convertibility has forced Argentina to align its monetary policy with that of the United States, despite the cyclical differences between the two countries. Due to a careful management of the maturity structure, the impact of the fall in capital inflows was not as sudden as if the debt had been contracted at shorter maturities. An excessively lax fiscal policy, especially in times of growth when substantial tax surpluses should have been obtained as a buffer against future crises, has played a role in creating vulnerabilities in the country, and the weakening of prudential defence in the banking system has contributed to the loss confidence in the national currency.

Under the conditions of monetary devaluation, the government further weakened the banking system by converting foreign-denominated assets and liabilities at different exchange rates, imposing huge losses on banks.

Fiscal deficits and the vulnerability of the banking system were two key keys to the Brazilian currency crisis. Government policies also have indirect effects on bank leverage, but the crisis materializes due to the rise in the fiscal deficit under a fixed exchange rate regime and foreign exchange reserves that lead to a speculative attack when the limits credit requirements imposed by the lender are achieved.

Although the International Monetary Fund was initially set up for a purpose, this institution now obliges countries to subordinate themselves to the IMF's monetary policy without any right. IMF loans are presented to the nations as a bait. Many researchers believe that its main purpose is to bring together all the national banks of the world and that the IMF will play a key role in creating a world government, the golden dream of all freemasons, and will act as the world's central bank, which will issue a single world currency. [10] It does not matter whether the world will go out or not, their purpose is to establish a world government, and this will be done by high-level decision-making by politicians.

5. Perspectives, challenges and opportunities

As this paper has shown, both countries have faced challenges with their fixed exchange policies, and monetary devaluation has been the way to change the situation. However, the economic program after the devaluation was different. While Brazil moved to a flexible monetary policy and focused

monetary policy on inflation, with a fiscal policy consistent with macroeconomic equilibrium, Argentina chose a higher exchange rate and developed a monetary policy to support this rate of exchange. As demand grew and the economy reached higher production levels, the Central Bank began sterilizing the reserves received as a way to curb excessive inflationary pressures. However, the government has tried to control inflation by using strict price controls, export controls and taxes. Fiscal policy and default failed to support the macroeconomic situation, and the booming economy pushes the unemployment rate. [11] The situation in Argentina, however, seems weaker than in Brazil.

Despite the perceived weaknesses in the Argentine economic program, the consequences of the crisis have not produced much difference in the current performance of both countries. Economic growth resumed, inflation and exchange rates are kept under control, and debt seems to be between manageable intervals. However, the IMF supported Brazilian policies, while at the same time opposed many Argentinian policies. Was it important to follow the advice of the IMF? The answer seems to be "no".

One of the main objectives of the IMF is to help countries get through economic crises and help them grow. [12] From the comparison in this paper, the economic recovery was just as successful in Brazil as in Argentina. It is also true that positive conditions on international markets, high prices for agricultural exports and low interest rates have reduced the situation. As a result, the remaining question is whether the economic model can be supported in both countries and will be a success rate in the medium term.

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