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Floating or sinking?

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In Argentina, the government and the banking system are gearing up for the imminent flotation of the peso. This is a central element in the government's efforts to bring the country's economic and political crisis under control. But even if it succeeds, recovery is a long way off

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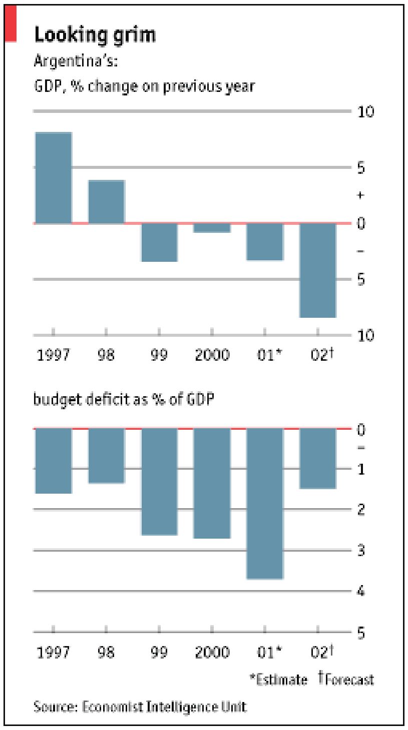
Duhalde faces a daunting task

FOR most Argentines, it has been a dismal start to the year: and there is little prospect of much improvement in the short term. When President Eduardo Duhalde took power on January 1st, he was the country's fifth president in a fortnight. His task was, initially, to stop the economic and political crisis worsening; and then, to take a grip on the enormous problems facing Latin America's largest economy. After making some rash—and hastily abandoned—promises, Mr Duhalde's government has at last come up with an economic plan that at least begins to tackle some of the most pressing challenges. But it is, perhaps inevitably, risky; and the greatest risk of all is the decision to float the currency, the peso, allowing the market to determine its value. After a delay, this is now scheduled to happen on February 11th. Ahead of this, the government announced that the banks, closed for nearly a week, would reopen on February 8th.

Even before its free float, the peso had roughly halved in value against the American dollar: a big shock after a decade of being pegged at par with the greenback. More than any other factor, it was the refusal of the now-disgraced government of President Fernando de la Rua (forced out of office in December) to contemplate devaluation that precipitated the crisis in which Argentina now finds itself.

The early benefits of the 1991 convertibility law, which established the currency board and, in effect, prevented the central bank from printing money, had been substantial. Hyperinflation was quickly brought down from over 3000%. But as the dollar appreciated in the late 1990s, the peg turned into a straitjacket for Argentina. Government spending rose, and so too did government borrowing, on a scale that was clearly unsustainable in the long-term. Interest rates rose, prices and wages fell. The economy slumped: it is now in its fourth successive year of recession. Something clearly had to give. In the end it was the currency board and the government—and the country's large government debt. (Argentina's default was the largest sovereign-debt default in history.)

Mr Duhalde inherited a freeze on most bank deposits, put in place in a last desperate attempt to save the currency peg. The outrage the freeze generated was what toppled Mr de la Rua, but, for the time being, it remains in place, to prevent a run on the banking system. The government's recovery plan, announced by Jorge Remes Lenicov, the economy minister, on February 3rd, involves both floating the peso and transforming a largely dollarised economy into one that must work in pesos. Originally, Mr Duhalde had—rashly—promised to repay dollar savings in dollars while converting the banks' dollar loans into pesos. Under the new plan, dollar loans will be turned into pesos at par. But dollar savings will be converted at a rate of 1.4 pesos to the dollar, and will then be indexed to inflation. The banks themselves will be compensated for their losses with government bonds.



On paper, the government is committed to tight monetary and fiscal policies, which should be the necessary accompaniment to freeing the peso. The Central Bank will print no more than 3.5 billion pesos this year. The budget, announced on February 5th and now being debated in Congress, is austere: it maintains the 13% cut in public-sector wages and pensions imposed last year; increases spending only on emergency help for the poor; and forecasts a fiscal deficit of 3 billion pesos, down from 10 billion pesos (then $10 billion) last year.

But the Central Bank lacks genuine independence and an inflation target. The government may find the easiest way to stick to its budget is to let inflation reduce the value of spending. It has also put off much-needed structural reform of provincial-government finances, a commitment made by the previous government to the International Monetary Fund (IMF) as a condition of its loan agreements.

After his short-lived dalliance with isolationist talk, Mr Duhalde and his government now seem committed to engaging with the IMF. They need the IMF's help and Mr Remes expressed disappointment on February 6th that the Fund had offered little in the way of public support for the government's economic plan. But the government is in contact with the Fund, whose officials have been in Buenos Aires. Mr Remes is due in Washington, DC, on February 12th, though the Fund has stressed that, as yet, no talks are planned on specific new loans.

America too has been, at best, non-committal in its encouragement of the government's efforts to bring the immediate financial crisis under control and to kickstart the depressed Argentine economy. Speaking to a congressional sub-committee on February 6th, John Taylor, the Treasury's under-secretary for international affairs, spoke of the need for Argentina to design a "sustainable economic programme". It seems clear that the international community regards the economic plan announced on February 3rd as only the first step in that process. Much depends on how much the peso depreciates once it floats, and on the Argentine government's ability to manage the consequences.

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But there is another broader reason for the IMF's current softly-softly approach. The Fund is acutely conscious that the finger of blame is already pointing at it for failing to prevent the crisis in Argentina. After all, it provided new financial assistance as recently as last August. Some critics have asked why it did not urge more radical reform on Buenos Aires. The IMF is always in a dilemma in such crises. If it provides help to a country whose policies are insufficient, in the Fund's view, to stabilise the economy, it is failing its duty to member governments and, ultimately, the taxpayers around the world who underwrite its resources. But if it withholds support, it risks driving the economy into an even deeper slump, for which it will surely get the blame. The Fund is in a no-win situation.

But the Argentine crisis will strengthen calls for a better early-warning system. Indeed, it has already done so. And Mr Taylor reiterated Washington's view that there could be a better system for more orderly sovereign-debt restructurings. This is an issue recently raised by the IMF's first deputy managing director, Anne Krueger. Such reforms will not help Argentina. But they may help others to draw lessons from the latest emerging-market crisis.