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U.S. Policy Toward Latin America: Lessons from Argentina

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Some critics blame Bush Administration policies for Argentina's collapse last year, but a closer look at that crisis will show that the Administration was right not to support extending Argentina another International Monetary Fund (IMF) loan. That approach would have prolonged Argentina's economic malaise, not solved it. Instead, U.S. policy should provide opportunities and incentives for countries to adopt economic reforms and institute the rule of law, not to help them become more dependent on international lending.

The Bush Administration demonstrated its understanding of this principle by making two important policy changes last year. First, it stopped the policy of blindly bailing out countries in crisis; and second, it reinvigorated U.S. leadership on trade by pursuing trade promotion authority (TPA), which enables it to pursue free trade agreements. Together, these strategies will encourage troubled Latin economies to adopt the necessary reforms on their own—which is the only guarantee that such reforms will last.

Lessons from Argentina. Some have argued that the fall of the Argentine economy was the result of U.S. foreign policy—specifically, the Administration's failure to back another international bailout of Argentina when collapse was imminent. These critics ignore the fact that Argentina's crisis is the direct consequence of poor economic policy choices implemented by successive governments. Though Argentina had adopted a few free-market policies, it failed to make the necessary institutional reforms to buttress them. Moreover, it resorted to increasing debt and raising taxes—policies that make it more difficult for markets to develop or expand.

U.S. policymakers can learn three valuable lessons from Argentina on how to handle Latin countries in distress.

Lesson #1: International bailouts encourage risky behaviors by governments and investors alike. If anyone must share the blame for Argentina's crisis, it is the International Monetary Fund. Its own archives show that, since 1983, it has provided nearly continuous funding to Argentina regardless of whether it met its prior loan conditions or was in fact in crisis. Such lending practice had two negative consequences. First, the IMF assistance became predictable and signaled to investors that their risk would be mitigated by a bailout: that investing in Argentina would bring a guaranteed profit regardless of how poor the economic conditions were. Second, the Argentine govern-

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ment had little incentive to reform; the money would still come in. These consequences led to Argentina's recent default, and they will lead to capital flight if the current government lifts the financial restrictions set by the previous government.

Lesson #2: Only when reform is genuinely desired by a country will it be effectively implemented, and IMF lending practices undermine the reform process. In August 2001, Argentina again requested IMF funding to shore up its economic problems. The immediate response from the United States was to question the worthiness of such an effort. Treasury Secretary Paul O'Neill, Federal Reserve Chairman Alan Greenspan, and Secretary of State Colin Powell, among others, publicly stated that Argentina's problems were of its own making and that new IMF loans were unnecessary. As a result of that strong position, Argentine authorities began to discuss economic reform. But when the IMF later announced that it would recommend an early disbursement of funds to Argentina, the discussions stopped. The response of the Argentine government clearly shows that IMF policies are counterproductive, inhibiting the very reforms they should encourage. Reforms must be homegrown to endure.

Lesson #3: Even when reforms are embraced, a strong rule of law is critical. The rule of law is vital to the success of economic reforms. It helps keep the reforms in place and restrains a government from annulling the law in order to undo a reform. Without reforms in the legal and judicial systems in Latin American countries, the future for these economies remains uncertain. Some Latin countries have made such reforms with demonstrable success, as illustrated by Chile, whose leaders have decided not to depend on IMF financing but to pursue economic and political freedom.

Priorities for a New U.S.–Latin America Policy. U.S. foreign policy toward Latin America should provide incentives for reform. Specifically, the Administration should:

- **Advance bilateral free trade agreements to provide greater opportunities for economic reforms to bear fruit.** The promise of free trade with America encourages reform. Though U.S. trade policy in the region is based on building a Free Trade Area of the Americas (FTAA), that strategy offers only a promise, not a certainty, of free trade. Consequently, it has had the opposite effect, inducing governments to stop liberalization efforts and use reform as a bargaining chip in negotiations with the United States. U.S. trade policy should encourage them to open their markets before trade negotiations occur. The Administration should offer to sign a free trade agreement with any country that has opened its economy. It is currently in negotiations with Chile, which supports free markets. Uruguay, which has taken consistent steps to open its economy over the past few years and which is attracting much of the capital leaving Argentina, could be the next candidate. This policy would encourage other countries to open their markets and make the necessary reforms in order to sign a trade deal with America.
- **Seek reform of the IMF to correct its counterproductive lending practices.** The basis for doing so can be found in the report of the International Financial Institutions Advisory Commission, chaired by Allan H. Meltzer of Carnegie Mellon University. It advocates, for example, a system based on a set of preconditions that countries must meet in order to qualify for a loan. These include sound fiscal policy, freedom of entry and operation for foreign financial institutions, and adequately capitalized commercial banks. Dependence on foreign loans, and future economic crises, will decline in Latin America if an environment develops that promotes the efficiencies and benefits of open markets.

Conclusion. The Argentine crisis demonstrates that Latin American countries must embrace capitalism in its entirety in order to achieve long-term prosperity. The United States should provide incentives for Latin countries to institute the needed reforms in order to rely less and less on international loans and to build and sustain their own prosperity over the long term.

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