

The IMF is Panama's Lender of First Resort

By

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On September 1, Panama inaugurated President Mireya Moscoso, the country's first female president and the wife of the late three-time president Arnulfo Arias. Ms. Moscoso was elected on a populist platform and has vowed to wipe out poverty in her five-year term. But even so, she would seem to lack the spending discretion that populist Latin American presidents have traditionally enjoyed. This thanks to the fact that her country has no central bank to print money and since 1904 has used the U.S. dollar as legal tender. Between 1955 and 1998, inflation averaged 2.4% per annum, and during the 1990s it barely exceeded 1% per year.

And yet the history of Panama's dollarization clearly shows that the absence of a central bank does not guarantee fiscal solvency. The shocking truth is that since 1973, except for a brief interregnum in the late 1980s during the Noriega years; Panama has been almost permanently under the tutelage of the International Monetary Fund. It has had 16 IMF programs during that time, the most recent of which was signed in late 1997 and is expected to run until late 2000. According to a new paper by IMF officials Michael Mussa and Miguel Savastano, during the last quarter of a century Panama has been the most assiduous user of IMF resources in the Western Hemisphere; since 1973, only Pakistan has had more IMF programs.

The lesson from Panama is that while dollarization provides for price stability, it cannot guarantee fiscal accountability. As long as the IMF exists, the temptation to use its generous funding programs as a surrogate for a central bank will likely be too great for most politicians to resist. Supporters of dollarization for Argentina should take heed; adopting the U.S. dollar, without placing fiscal restraints on politicians may lead to a permanent revolving IMF mission in Buenos Aires.

The main factor behind Panama's proliferation of IMF programs has been the government's inability, until very recently, to control its public finances. Between 1973 and 1998 the fiscal deficit averaged 4% of gross domestic product, and from 1973-1987--a period of continuous IMF programs--it exceeded a remarkable 7% of GDP. In fact, it has only been in the last few years that Panama has been able to put its fiscal accounts in order. Initially, very large fiscal deficits were financed through borrowing from abroad. But when the foreign debt became too high, the IMF stepped in with fresh resources. When this was not enough, Panama restructured its foreign debt.

Panama had its first IMF stand-by program in 1965. A year later the fiscal deficit was brought into check. In 1968, however, the public accounts again got out of hand, and the IMF was called back. Thus began remarkable 19-year period of uninterrupted IMF programs. Year after year, new IMF programs called for the strengthening of public finances. And, invariably, year after year, Panama failed to take serious action, as if the authorities knew that the IMF was there, ready to bail them out. This vicious circle was only broken in 1987, when as a result of General Noriega's confrontational attitude and suspected involvement in narcotics trafficking, Panama was subjected to severe U.S.-led economic sanctions. The IMF returned to Panama in September of 1990, with a monitored program. This was followed by lending programs in 1992 (22 months), 1995 (16 months), and 1997 (36 months). Significantly, in the last few years the

government has finally acknowledged the need of maintaining a solid fiscal position. Between 1990 and 1996 the country posted public-sector surpluses, and in the last three years it has run modest deficits. It is too early to know whether Ms. Moscoso will strive for fiscal solvency.

Last September Argentine President Carlos Menem's stated that Argentina was willing to give up the peso and adopt the dollar as legal tender. He argued that without a currency of its own Argentina would not be subject to ill-founded devaluation rumors, nor would it be affected by "contagion" from other emerging countries. The idea has since been promoted by a number of academics and institutions, including the Inter American Development Bank. In Argentina this proposal rapidly became a focal point of the political debate. While both major presidential candidates in Argentina have publicly rejected the idea, the discussion continues at full speed in academic circles, think tanks and in the media. Argentina's next president will have to face the exchange-rate issue squarely during the first few months of his tenure.

Argentina--with its commitment to a fixed-exchange rate, a large stock of international reserves, a de facto quasi-dollarized economy, and a currency board--is indeed an ideal candidate for full dollarization. But before moving in that direction policy makers should carefully study Panama's monetary history. Unless Argentina wants its economic policy to be run by the IMF, it must build the institutions required to maintain fiscal discipline. The proof of this danger is already evident in the fact that the IMF has been in Argentina since 1995.

The recent approval by the Argentine Congress of the Fiscal Convertibility Law--which requires fiscal balance by 2003, and calls for the creation of a fiscal stabilization fund--is a step in the right direction. It is not enough, however. Legally, the law is too limited, and can be modified by the annual budget. Argentina needs a truly credible fiscal commitment, enacted through legislation that requires a super-majority to be amended. Moreover, to prove that the country is serious about modernization, some of the most obvious sources of potential fiscal imbalances should be eliminated swiftly. Argentina's system of revenue sharing with its provinces must be reformed in order to rein in reckless spending at the provincial level. Government-owned banks--historically a source of fiscal largesse in most of Latin America--and in particular the giant Banco Nación should be privatized or closed. Government debt--which in the past few years has skyrocketed to over 40% of gdp--should be retired gradually. These fiscal measures must be complemented by the adoption of the perennially postponed labor-market "flexibilization."

After adopting an institutional framework for credible fiscal responsibility, Argentina should move quickly--and unilaterally--towards full dollarization. This would consolidate the gains achieved since the pegging of the peso and the adoption of the currency board in 1991. With devaluation rumors and the IMF out of the picture, Argentina would not only recover but is likely to become an economic dynamo in Latin America.

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