The Monetary and Fiscal History of Argentina

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Comments by Andrew Powell*
(*strictly my views only, not those of IDB)

“The Monetary and Fiscal History of Latin America”
IDB, September 24th/25th 2018
Congratulations to the Authors!

- Some 57 years of Argentine economic history in 20 pages! (excluding graphs and tables)
- Very succinct, the main arguments very clear
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- Some 57 years of Argentine economic history in 20 pages! (excluding graphs and tables)

- Very succinct, the main arguments very clear

- I found myself wanting more, especially storyline…
Three big take-aways

- It’s all fiscal, the “…same disease: the inability to restrict spending to genuine tax revenues”
- The currency board “worked”, it brought down inflation and the deficit, the primary deficit on average zero…
- Multiplicity of equilibria (Calvo 1988, Ayres et al 2015)

- I will make a comment on each,
- And then a concluding remark on banks…
Comment # 1: It's all fiscal...

Here's the critical identity...

But what drives what?
Comment # 1: It's all fiscal...

- There's considerable discussion of the deficit to inflation link, much less about other potential causalities, interactions, feedback loops...

- E.g.: 1976-90: the highest deficit period, deficit correlated with inflation, but also the lowest growth period and debt, inflation, default surely had impacts on growth & then on revenues...

- And the 1980’s critical to the growth story…
Authors note the disappointing growth story since mid 1970’s…
This figure suggests the 1980’s is key...
Aside on the 1980-1982 banking crisis...

- Following 1977 liberalization of the banking sector, increases in interest rates, credit and real estate prices, all under weak regulation and supervision.

- First major bank to fail was March 1980 followed by 3 other banks in following days, before 1981 deval.

- Crisis triggered by liberalization boom, the 1981 devaluation deepened the extent of the crisis…
Resolution of 1982 crisis...

• The resolution of the 1982 crisis was very expensive
• Exchange rate guarantees, full deposit insurance…
• But also 71 banks were liquidated, liquidating banks generally very very expensive
• **AND** when assets separated and not in a going concern, asset recovery generally very poor indeed…
Comment #2: the currency board worked and brought down the fiscal deficit and debt

- For sure, there was a structural break but this seems a weak definition of “worked”…

- In the end the currency board did not yield the fiscal discipline required to ensure the scheme was sustainable, in the face of a set of negative shocks
Comment #2: the currency board worked and brought down the fiscal deficit and debt...

In the good years, 1996/7 growth 5.5% and >8% more but primary barely positive
Primary on average zero, debt accumulation due to interest payments...

- The “required adjustment” (to keep debt constant) was modest (at least until 2001 – see Argentina’s Avoidable Crisis and Bill Cline’s book)....

- But perhaps due to the combination of external shocks and tricky internal politics this did not happen

- The rise in interest rates (and the distance between the primary and overall deficits) reflected rising perceived default probabilities....
Comment # 3: Multiple equilibria…

• The authors clearly like multiple equilibria stories…

• One possibility is on debt and interest rates as per Ayres (2015) but how can one distinguish between that and a (simpler) story of a set of institutions that could not “adjust” to new realities?

• If authors wish to push the multiple equilibria story would be good to find ways to refute other views…
Other potential multiple equilibria…

- Other possible multiple equilibria stories…

- Deposits in the financial system were a critical signal and became v. important to finance government…

- Authors suggest a continuous outflow of deposits in 2001, but actually up to four distinct runs…
Deposit runs late 2000 and 2001……

June/July run was very serious

Halted by August IMF Agreement, for a While

And then came the “zero deficit” policy:

A case of changing beliefs and common knowledge?

Source: Argentina’s Avoidable Crisis (20002)
IMF as lender of last resort, multiple equilibria or mixed strategies...

- BCRA had built up significant defenses “systemic liquidity policy”, could have more detail in the paper...

- But role of the IMF also critical, underplayed in the paper

- Often not clear if there was an Agreement or not

- Equil’m in mixed strategies (Arozamena and Powell 2003)

- The August agreement - according to Mike Mussa, “the worst decision the IMF ever made”...
A word on the 2002 resolution...

- Private banks had significant amounts of liquidity and capital, the private sector was long dollars abroad and short domestic dollar loans...

- The *asymmetric pessification* plus maxi. depreciation was a huge transfer to Argentine small and medium sized businesses, without differentiating across banks

- It wiped out the capital of the banks, and sowed the seeds of a relatively fast recovery without credit..
Private sector was long dollars...

### Table 2. Argentine External Assets and Liabilities: Public and Private Sector

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<td>65</td>
<td>147</td>
<td>118</td>
<td>61</td>
<td>53</td>
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</tbody>
</table>

Source: Argentine balance of payments, Ministry of the Economy; public sector assets, Central Bank of Argentina. 

a. Balance of payments definition includes government deposits held at the central bank, excludes government bonds in U.S. dollars. Private sector is sum of financial and nonfinancial private sector. Figures are net of external assets with no return.

Source: Argentina’s Avoidable Crisis (2002)
Final remark…

- Perhaps should be Monetary, Fiscal and Banking History - or there should be a follow-up on banking

- The 1982, 1995 and 2002 banking crises (origins, management and resolution) are v. important to understand fiscal and monetary history…

- The authors use M2/GDP as a measure of contingent liabilities but this is pretty crude (assumes banking system assets worth zero).
The EU has an exposure of > 200% of GDP on that measure...

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Assets</th>
<th>Liabilities</th>
</tr>
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<tbody>
<tr>
<td>46.9</td>
<td>24.0 Total</td>
<td>286%</td>
<td>146% Total</td>
</tr>
<tr>
<td>15.5</td>
<td>Other Liabilities</td>
<td>95% Other Liabilities</td>
<td></td>
</tr>
<tr>
<td>7.4</td>
<td>Capital</td>
<td>45% Capital</td>
<td></td>
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</tbody>
</table>

Trillion of Euros

As % of EU GDP

EU GDP was 16.4 Trillion Euros in 2015

While Argentina’s maximum banking liabilities were always below 20% of GDP and lower than most LAC countries...
Resolving banking crises...

- Given moral hazard concerns, pre-crisis regulation and supervision very important - Calomiris and Powell 2001

- Deposit insurance necessary (Tequila crisis) but not 100% and should never bail out the bankers...

- Retain as much of the bank as a going concern as possible - Argentina introduced innovative scheme post-Tequila to resolve banks copied in several countries
Thank you!
Is it really **all** fiscal or growth?

Primary fiscal deficit 1%
Initial debt 50%
Growth 5%
Interest Rate 3%

D/G stays constant @ 50%
Comment #2: Is it fiscal or growth?

D/G

Growth 2.5%
Comment # 2: Is it fiscal or growth?

Growth 2.5% with a 0.2 multiplier, growth to revenues
Comment # 2: Is it fiscal or growth?

Growth 1% with multiplier impact on revenues
Comment # 2: Is it fiscal or growth?

Decreasing growth rate and multiplier impacts

Fiscal deficit 1%
Optimism bias in LAC for 2016 expected growth rates

Budgeted (late 2015)

Optimism bias

\( y = 0.8266x + 0.5319 \)

WEO Oct. 2015