The Case of Uruguay
Comments

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Plan

1. The paper

2. How was Uruguay able to bring about the Golden period (after 2002 crisis)?

3. The paper in the project
1. The paper
The paper

• Comprehensive and compelling story of the evolution of fiscal and monetary policy in Uruguay

• Highlighting major macroeconomic crises that ruptured the process

• Little to disagree with, but I will try
Summary of the paper (1)

• **Stagflation 1960-73.** Financial repression and inflationary financing. Banking crisis (why?) created fiscal liabilities and spiral of inflation/devaluations. Price controls collapsed due to external shocks.

Summary of the paper (2)

- **Boost and halt 1991-2002.** Fiscal adjustment, Brady rescheduling and access to finance, financial dollarization, and crawling peg. Negative shocks (Brazil 1999 devaluation and Argentina collapse) led to depleted international reserves. By 2002 to run on bank deposits, devaluation, unsustainable dollar public debt.
• **Golden years 2003-2017** *should be a different period.* In 2003, public debt reprofiled, *deep fiscal adjustment and banking crisis resolved with multilateral help (unmentioned).* After 2003, high growth with XR flexibility, inflation targets and reduction of financial vulnerabilities, with some slippages in recent years.

• “many changes made before 2002 laid the foundation for a stronger economy. This explains part of the recovery as of 2003” *(not sure about it)*
2. How was Uruguay able to bring about the Golden period (after 2002 crisis)?

A period of high growth underpinned by low inflation and flexible XR as well as restrained fiscal policy
Not clear that policies in the previous period were enabling factors

• The dollar appreciation created by crawling peg was possible only because Argentina and Brazil followed the same path; critically dependent on reserves and vulnerable to regional shocks.

• Following Brazil 1999 devaluation and Argentina recession, Uruguay did not adjust crawl, debt increased, captured hot Argentinean deposits, let financial dollarization grow.

• The Argentina collapse led to bank run (fear of corralito), credit disappeared, country risk exploded.

• *Boost and halt, or tripping again with the same stone?*
One key was the model resolution of the 2002 crisis, which had Argentinean potential (opposite to 1982 crisis)...

- Minimalist bank resolution focused on the payment system (with multilateral support), friendly reprofiling of time deposits only in sick banks, facilitate renegotiation respecting contracts.
- Minimalist public debt reprofiling, with marginal loss ex-ante
- Fiscal adjustment with wage austerity and broad political support
- Careful monetary policy to keep inflation low
...followed by constructive policies

• Some good luck
  – Lula started with the right foot
  – Decrease in world interest rates (bondholders actually gained ex-post; country risk record low)

• Fiscal restraint
• Active debt risk management (stretching maturities, lines of credit, peso debt)
• Prudential policies for financial dollarization
• Reduction in regional trade and financial vulnerabilities
What is missing to make it beyond the point of no return?

• Fiscal restraint dependent on simply avoiding big deficits may create risks in good times:
  – Need fiscal institutions able to underpin structural fiscal policies
  – Need structural fiscal rules with appropriate reaction function to structural debt and social security projections

• Strengthen commitment to inflation targets; de-index wage negotiations

• Multilaterals: better vehicles of contingent financing for liquidity and temporary shocks.
3. The paper in the project
Paper restricted by inflation focus

- It reads as a history of inflation, centered on nominal instability: “the aim is to explore the links between [...] policies, nominal instability and macroeconomic performance”

- KNS: “the purpose of this project is to test the hypothesis that bad fiscal policy [...] was a main responsible for macroeconomic instability: BOP crisis, financial crisis, defaults, hyperinflation, etc.”
The inflation focus is key in Uruguay

• Inflation has inertia, so it remained a problem even when initial disequilibrium ceased

• Apart from direct costs (lower savings, distorted investment), it led to risky financial dollarization

• Disinflation policies are costly (recessionary) and potentially risky (real appreciation and BOP crises), as Uruguay shows
But the paper may benefit from broadening its perspective

• Excessive focus on inflation tax
• Address the origins of the crises identified (and those that were avoided) irrespective of whether nominal stability considerations are relevant
• Attribute the responsibility of policies in a more systematic, analytic fashion...
• ...filtering out the role of extreme external shocks and the availability of multilateral financial support, two key complementary factors in Uruguay’s crises.