

Discussion of the History of Argentina 1

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The main contribution of these essays is to view a variety of experiences within the bare-bones framework spelled out in this volume’s “A Framework for Studying the Monetary and Fiscal History of Latin America.” The effort is especially valuable for the case of Argentina because the large number of trees that history throws in our way threatens to rapidly occlude the view of the bush. The authors are able to offer a narrative that helps give a rationale for the variety of facts and policies discussed in “The History of Argentina.” The chapter covers the period 1960 to 2017, which starts in the midst of an inflation stabilization program that saw the annual rate of inflation hover around 100 percent in 1959, the highest since the beginning of the century. But this record was not going to last. As shown in Figure 2, inflation reached hyperinflation levels (according to Phillip Cagan’s [1956] definition) in the late 1980s. These facts could lead the reader to quickly sympathize with the authors’ conclusion that “from 1960 to 1990, a systematic imbalance between government revenues and outlays explains the chronic and high inflation rates that Argentina experienced during those three decades.” But soon she will realize that the imbalance that the authors refer to could hardly be captured by conventional variables. For example, Figure 3 shows a clear downward trend in the government deficit as a share of GDP. Thus if the government deficit were taken as a measure of “imbalance”—and few economists would raise an eyebrow at that choice—the implication would be that inflation increases as imbalances go down, which goes against the chapter’s conclusions. An important contribution of the chapter is to show that the excess of outlays over revenues is caused by factors that are not directly under the control of government, such as terms of trade, the sharp rise in the real exchange rate, liability dollarization, and the tightening of international credit conditions, all of which in several cases go far beyond government deficits. These factors become increasingly relevant as the economy became more financially integrated with the international capital market and as the latter suffered major shake-ups, dramatically exemplified by Volcker’s stabilization plan in the early 1980s. Figure 5, for instance, shows that fiscal deficits alone would be wide of the mark for explaining the sharp rise in government debt in the 1980s and early 2000s.

Let me now take a bird’s-eye view of “imbalances” in the period covered by the chapter. The government deficit is relevant for the early 1960s, given that the public sector

had limited access to the bond market and expenditure shocks needed to be financed by the central bank, increasing the money supply. This established a tight link between deficits and inflation, and inflation was easy to rein in by tighter fiscal policy. However, that situation changed in the 1970s when governments relied on price controls to keep inflation in check. This generated a break in the link between deficits and inflation, a clear instance in which fiscal imbalance does not lead to inflation (as measured by the statistical office). But that was not to last long. When controls were lifted, the price level rose steeply in a rush, giving rise to a phenomenon that I like to call “inflation explosion.” An episode of that sort that is deeply imprinted in Argentines’ collective conscience is the so-called *Rodrigazo* in 1975 (in reference to Celestino Rodrigo, the minister of the economy in charge), in which the dollar exchange rate increased by around 150 percent, far exceeding the rise in the wage rate, and which not long afterward led to the ousting of the president in charge.

The new administration took a sharp turn toward free market policies and liberalized the banking and financial sectors, resulting in a large expansion of quasi-monies. As pointed out in the chapter, one implication of this was to make the central bank’s contingent liabilities grow, since the central bank was expected to bail out failed financial institutions. Thus a sensible definition of “imbalance” would have to take these new contingent liabilities into account. Being contingent, these liabilities do not increase government expenditure and the fiscal deficit as long as financial institutions are not subject to runs. But the inflationary impact could be large and unexpected when they do. This threatens governability and can generate chronic inflation, as economic agents lose trust in the central bank’s ability to stabilize the price level. For instance, the latter may lead price setters to keep updating prices at a high tick, giving rise to *price inertia* and increasing the cost of inflation stabilization. This is the sort of phenomenon behind the Austral/Primavera episodes that ended in the 1989 hyperinflation while the government deficit (especially the primary deficit) showed no dramatic rise, as I will show below.

As pointed out in the chapter, access to capital markets improved considerably in the 1990s. The Brady Plan probably contributed to this by placing in the market bonds that were previously on lenders’ balance sheets. This gave incentives for the creation of emerging market economies (EMs) desks in investment banks, which further facilitated access to the international capital market by private and public operators in EMs. The dismal outcome that followed is well known, and Argentina was not absent from the crises that started to occur from 1994 to 1995 (the Tequila crisis). These crises are associated with sudden stops—that is, large and largely unexpected cuts in capital inflows (see Calvo 2016). Sudden stops give rise to imbalances because, whatever the prior fiscal policy stance, the associated credit drought tends to turn sustainability into unsustainability in the fiscal sphere. Culprits are hard to find because EMs were mostly innocent bystanders, and investment banks were just doing their business (losing their shirts, sometimes, as the Lehman Brothers crisis demonstrated in 2008). But, again, in the final analysis, when Argentina was involved, the “imbalance” mentioned by the authors was always present. For example, the 2001 crisis, the costliest crisis since the beginning of the twentieth century for Argentina, occurred not because Argentina went on a crazy shopping spree but because the interest bill skyrocketed

and terms of trade with respect to Brazil (a large trading partner) sharply deteriorated (see Figure 13 and Calvo, Izquierdo, and Talvi 2004).

Argentina's inflation explosions are worth exploring in greater detail. I call them "explosions" because they exhibit inflation rates that are orders of magnitude higher than those occurring shortly before and, as a general rule, are cases in which financial and other considerations dominate primary fiscal deficits. Figure 2 very clearly shows the 1989 and 2001 explosions that seem to come from nowhere. This is not the place to elaborate on these episodes at length, but some broad brushstrokes offer interesting insights. The Austral program, for instance, starts in June 1985 after what I like to call the Volcker Bomb (i.e., the large increase in the Federal Reserve's interest rate in 1982 that had deleterious effects on indebted less-developed economies and triggered the lost decade of the 1980s). The rise in the interest bill had a large impact on the government deficit. Believing that the situation was getting out of hand, the Argentinean government decided to change the unit of account from peso *to* austral *and* define the interest rate in austral in such a way that it was free from the high inflation expectations involved in the peso interest rate (a clever trick called *desagio*), a subterfuge that prevented the emergence of a wave of inefficient bankruptcies and helped initially stabilize inflation expectations. The program was very successful in the short run. Inflation fell as though stricken by a thunderbolt. The primary deficit improved to the point of turning into a sizable surplus, due partly to the Olivera-Tanzi effect. However, the lack of credibility regarding the government's ability to stick to price stability and other factors once again increased the burden of the interest bill on the government budget, which, combined with the fact that elections took place at the end of 1989—and that the winner campaigned on promising a big salary increase (*salariazó*) and hinted at debt default—led to a sharp rise in prices that the central bank had to accommodate to prevent a politically costly increase in unemployment. This set up conditions under which price inertia dominated, and even though a new program was put in place in August 1988 (the Primavera plan), it was not sufficient to assuage inflationary expectations, a situation that eventually ended up in a couple of brutal hyperinflation episodes (annual inflation reached 16,000 percent), while, as shown in Figure 3, the government deficit shows a clear downward trend from 1975 to 1989, totally oblivious to the monetary tragedy that was going around!

In sum, the authors are right in pointing to imbalances as key factors behind the dismal outcome of Argentina's economy. After reading the chapter, I felt much wiser but, at the same time, eager to learn more about these fascinating episodes. Questions about fundamental issues that may help explain the coexistence of imbalances with low growth, for example, popped up in my mind. Are low growth and a propensity to be caught in financial crises parts of the same tree? I think the issue of low saving rates deserves further study in this respect. Argentina's current saving rate is around 12 percent of GDP, much lower than the average for Latin America—not a high bar, since Latin America's saving rates look like pygmies relative to Asia's. Following Feldstein and Horioka (1980), one is tempted to conjecture that low saving is a possible explanation for slow growth, but there is also the question of whether low saving rates also make economies more susceptible to balance of payments and financial crises. After all, given technology, the

smaller the saving rate, the greater will likely be dependence on external saving, thus possibly making the economy more sensitive to episodes of systemic sudden stops that are typically external to the economy in question and accompanied by balance of payments or financial crises. Moreover, repeated systemic sudden stops, as has been the case since the Volcker Bomb in the early 1980s, are likely to undermine the reliability of domestic financial intermediaries and depress the propensity to save, especially for individuals and small and medium enterprises that do not have easy access to the international capital market and can hardly keep their savings in a safe place. Therefore, there could be a vicious circle in which low saving triggers a high incidence of balance of payments and financial crises and the latter feeds back into lower propensities to save.

I will be eagerly looking forward to future volumes of this project!

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