

Progressive Monetary Policy in Argentina: A Return to Democratic Control

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While monetary policies have been dominated by restrictive 'inflation targeting' across the world over the last two decades, one of the last places to look for progressive economic policy has been a central bank. Most commentators would have assumed, in effect, that no central bank in the world was pursuing a growth-focused mandate.

Yet in Argentina in March 2012, the legislature and the president approved a new *Ley Organica* for the central bank that incorporates an unambiguous growth mandate (See <http://jweeks.org>).

This is in stark contrast to Argentina's earlier monetary policies. During the 1990s, for instance, the government dedicated itself to a neoliberal economic regime, marked most infamously by the adoption of a 'currency board' monetary regime. The currency board tightly tied Argentina's domestic money supply to the central bank's holdings of foreign exchange.

This exchange-rate regime included a fixed peg to the U.S. dollar, unlimited and unconditional conversion of the national currency (the *peso*) into foreign currencies, and the requirement that the central bank's holdings of foreign-exchange reserves be equivalent, at least, to the domestic components of the country's monetary base.

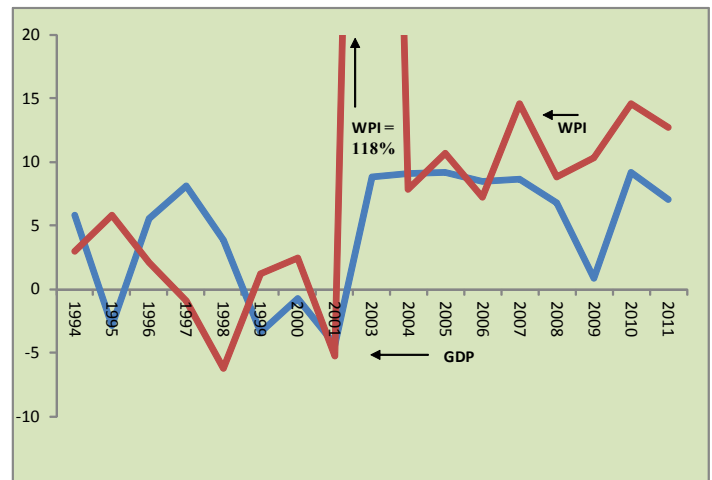
Initially lauded by neoliberal economists as the quintessence of a sound monetary policy, this regime imploded spectacularly towards the end of the decade. This disaster ushered in a 20% fall in national income during 1998-2002. In addition, inflation skyrocketed to over 100% in 2002 (See Figure 1). Panicked, the government dramatically changed its monetary policies that same year.

The Lack of Democratic Input

The example of Argentina's currency board underscores a central characteristic of neoliberal economic regimes: the removal of economic policymaking from democratic influence. Such regimes advocate monetary policies that are 'independent', i.e., under the uncontested control of so-called experts.

For neoliberals, 'independence' of central banks signifies no political oversight via the democratic process. This differs from the 'soft' independence of the U.S. Federal Reserve, which requires, at least, regular reporting to Congress. An extreme case of lack of oversight is found in Indonesia, where the central bank enjoys 'hyper-independence' (in response to the advice of the IMF). In this case, the president could *not* remove the governor, even on the grounds of misconduct.

Figure 1: Argentina, Growth Rate of Real GDP and the Wholesale Price Index (WPI), 1994-2011



Source: <http://www.iadb.org/Research/LatinMacroWatch/lmw.cfm>

Neoliberalism's approval of restrictive monetary policies goes hand in hand with the restrictions that it places on the effective use of other macroeconomic policies. For example, it preaches the necessity of balanced budgets, a stance that removes any basis for counter-cyclical fiscal policies. It also endorses 'flexible' or 'market-determined' exchange rates, which undercut the possibility of intervening to rationally manage the exchange rate.

The general 'decommissioning' of macroeconomic policy tools is capped off by guaranteeing the 'independence' of the central bank from political oversight. This extreme insulation from the democratic process (epitomized, for example, by the dysfunctional European Central Bank) leaves governments very few policy instruments with which to pursue any desirable goal other than strict controls on inflation.

From Neoliberalism to Social Democracy

The election in Argentina of Nestor Kirchner in 2003 occasioned a dramatic shift from neoliberalism to social democracy. This change continued and deepened with the election in 2007 of Cristina Fernández, and her re-election in October 2011 on the basis of almost 55% of the vote.

After 2003 the ensuing change in national economic performance proved as dramatic as the shift in the national economic regime. After five years of decline, real national income grew at an annual average of 7.5% during 2003-2011, and inflation averaged slightly less than 10% (see Figure 1).

Though criticized by neoliberals, this rate of inflation was modest for post-World War II Argentina. Indeed, it is plausible that the structural basis for inflation in Argentina has been reduced by this extended growth process, the longest sustained expansion in a generation (except for the externally induced dip in 2009 due to the global crisis).

Though economic policy had changed dramatically in Argentina during these recent years, it remained constrained, unfortunately, by the legal legacy of the dysfunctional currency board. This problem manifested itself in 2010 when the governor of the central bank adamantly refused to use foreign currency reserves to service the country's external debt. He argued that this action would break the strict rule that the Central Bank should hold reserves equivalent to no less than 100% of the domestic monetary base.

Faced with a central bank determined, in effect, to induce default on the country's debt, President Fernández sacked the governor, replacing him with Mercedes Marcó del Pont, then president of the largest commercial bank in Argentina.

Reforming Monetary Policies

The appointment of a new governor has been accompanied by the introduction of a new legal framework for the central bank that institutionalizes its ability to implement counter-cyclical monetary policies. This new law eliminates the strict link between the country's foreign exchange reserves and its money supply, which had led invariably to deflationary monetary policies.

The importance of this change cannot be over-estimated because it provides an enabling environment for rational economic policy-making. For example, *targeting* an explicit inflation rate only makes sense when the rate is considered to be either a lower boundary (in order to avoid deflation, i.e., a general fall in prices) or an upper boundary (to avoid destabilizing high inflation).

Argentina's new stance enables counter-cyclical monetary policy to function as a valuable complement to counter-cyclical fiscal policy. It also simultaneously enables rational debt management, rather than artificially linking national debt to the stock of foreign-exchange reserves. This stance also allows, of course, the central bank to coordinate its interventions in the currency market with the medium and long term development policies of the country.

Additionally, this regime allows for greater flexibility in deficit finance. Previously, the currency board rule that linked reserves to the domestic monetary base prevented, in practice, any monetizing of the deficit (financing of government deficits by the central bank).

Though neoliberals consider monetization to be the ultimate policy sin, when it is implemented pragmatically, it opens up

desirable policy space for the government. For example, in the last ten years it has been one of the key tools enabling the government of Argentina to avoid having recourse to expensive foreign borrowing to cover its fiscal deficits.

But, above all else, the new *Ley Organica* institutionalizes the principle that the function of monetary policy is to help achieve long-range development goals, and to coordinate with fiscal policy in selecting and prioritizing such goals.

The Return to Economic Sanity

Forty years ago the coordination of fiscal, monetary and exchange rate policy as a basis to facilitate economic growth and development was standard practice in both developed and developing countries. In 1969, for instance, the Bank of Sweden awarded Jan Tinbergen its 'Nobel Prize', in part for his famous 'Tinbergen Rule' of policy coordination.

This rule states that the number of policy instruments used by the government must be at least equal to the number of goals that it seeks to achieve. For example, while a strict neoliberal monetary policy, such as a currency board, is targeted at achieving a low inflation rate, it cannot be expected simultaneously to promote growth-inducing domestic investment (without coordinating with fiscal policies) or an expansion of exports (without coordinating with exchange-rate policies).

Progressives across the world should strongly support the Argentinean government for the return to economic sanity that is embodied in its new central bank law. The legal formalization of the sensible rule that monetary policy should be a positive instrument for promoting the general welfare vindicates the arguments of many heterodox economists.

More important has been the government's reassertion of the principle that monetary policies—just like other macroeconomic policies—should be subject to democratic oversight. Just as George Clemenceau once remarked that "war is too important to be left to the generals", we should re-instate the rule that economic policy is far too important to be "left to economists".

Experts advise and elected representatives decide: this is called "the democratic process". We can be thankful to Argentineans for reminding us that such a rule should apply *even* to central banks.

For further lively discussions of timely macroeconomic issues from a heterodox perspective please see John Weeks' website and blog: <http://jweeks.org>