

Getting the Priorities Right: The new central bank law in Argentina

John Weeks

Over the last two decades of "inflation targeting" policies, one of the last places to look for pragmatic economic policy was a central bank. In answer to the question, in what country does the central bank have a growth focused mandate, most would answer, "there are none" or "beats me". Yet, there is at least one. In Argentina the Ley Organica for the central bank, passed by the houses of the legislature and signed by the president in March 2012, incorporates an unambiguous growth mandate. And if this does not make the Central bank of Argentina unique, combining it with a woman as the Governor certainly so qualifies it.

During the 1990s, the government dedicated itself to a neoliberal economic regime, most infamously with the adoption of a currency board. This excursion into monetary policy madness tied the domestic money supply to central bank holdings of foreign exchange. Initially lauded by neoliberals as the quintessence of sound monetary policy, it spectacularly imploded at the end of the decade. The disaster ushered in a twenty percent fall in national income during 1998-2002. Inflation went over 100 percent in 2002 when accumulating disaster forced the government abruptly to abandon its ill-advised currency regime (see chart).

A central project of neoliberal ideology is removing economic policy from the democratic process, to render it "independent" and unaccountable, under the control of so-called experts. The ideology preaches the necessity of balanced budgets to decommission counter-cyclical fiscal policy. "Flexible" or "market-determined" exchange rates provide the vehicle to discard an interventionist currency regime. The decommissioning of policy tools is completed with central bank "independence" that excludes political oversight. This extreme insulation from the democratic process, epitomized by the dysfunctional European Central Bank, leaves governments with few policy instruments to pursue any goal other than deflation (aka "inflation targeting").

The election in Argentina of Nestor Kirchner in 2003 brought a dramatic shift, from neoliberalism to social democracy. This change continued and deepened with the election in 2007 of Cristina Kirchner, who was re-elected in October 2011 with almost 55 percent of the vote. Nestor died of a heart attack at the end of 2010.

The change in national economic performance proved as dramatic as the shift in policy. After the five years of decline, real national income grew at an annual average of 7.5 percent during 2003-2011, and inflation averaged slightly less than ten percent (see chart). While hardly to the delight of the neoliberals, this rate of inflation is quite modest for post-war Argentina. Indeed, it may be that the country's structural inflation has been reduced by this growth, the longest sustained expansion in a generation (sustained except for the dip in 2009 due to the global crisis).

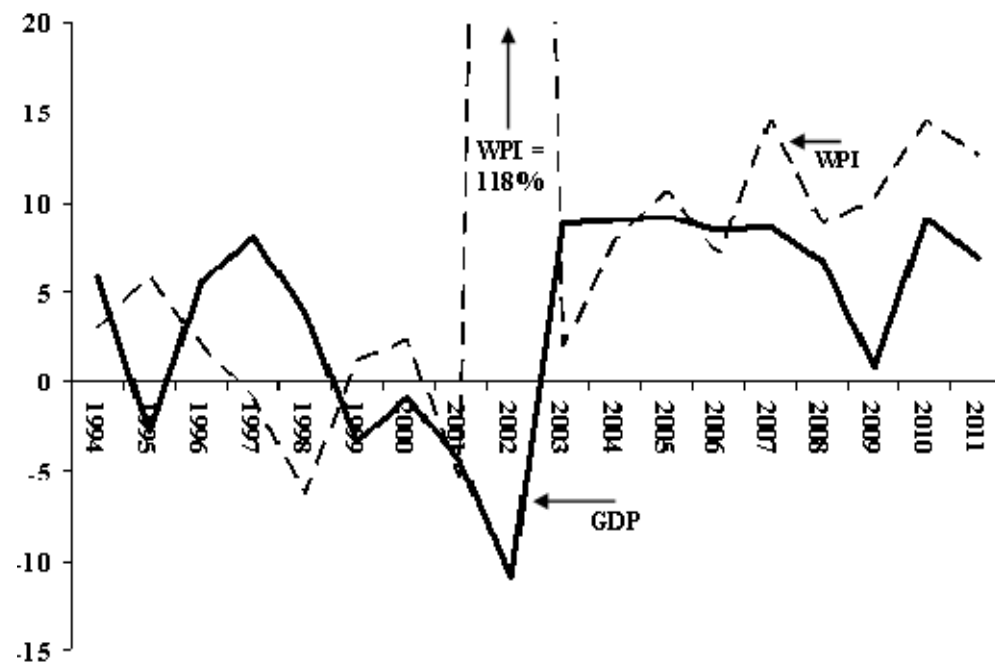
Though economic policy changed dramatically, it remained constrained by the legal legacy of the dysfunctional currency board. This dysfunctionality manifested itself in 2010 when the governor of the central bank refused to use currency reserves to service the country's external debt. Faced with a central bank induced default, President Kirchner changed the governor,

replacing him with Mercedes Marcó del Pont, then president of the largest commercial bank in Argentina.

With a new governor has come a new legal framework for the central bank that institutionalizes the ability of the bank to implement counter-cyclical policy, in contrast to the previous framework that institutionalized the opposite. The new law eliminates the pro-cyclical link between foreign exchange reserves and the monetary base. The importance of this change cannot be exaggerated, for it enables rational policy making. If "inflation targeting" has a rational justification, it must refer to the lower boundary (avoiding destabilizing deflation) as well as the upper boundary (avoiding destabilizing inflation); that is, the change enables counter-cyclical monetary policy, to complement counter-cyclical fiscal policy. It simultaneously enables rational debt management, rather than constraining that management by an analytically unrelated reserve link. And, of course, it allows the central bank to coordinate currency market interventions with medium and long term industrial policy.

But most important, the new Ley Organica institutionalizes the principle that the function of monetary policy is to achieve a range goals, and in coordination with fiscal policy to select among and prioritize goals. Forty years ago the coordination of fiscal, monetary and exchange rate policy to facilitate growth was standard practice in both developed and developing countries. In 1969, the Bank of Sweden awarded Jan Tinbergen its "Nobel Prize" in part for his famous "Tinbergen Rule" of policy coordination.

Social democrats and other progressives all over the world owe thanks to the Argentinean government for the return to economic sanity embodied in the country's new central bank law. The legal formalization that monetary policy should be a positive instrument for the general welfare vindicates the arguments of generations of heterodox economists. More important, the re-inserting of the central bank into the political economy of policy making embodies the principle that all policy should be subject to democratic oversight. Just as "war is too important to be left to the generals" (Georges Clemenceau), economic policy should not be left to economists. Experts advise and elected representatives decide. It is called "the democratic process", and Argentineans think it should apply even to central banks.



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

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