Discuss this article at Jt: http://journaltalk.net/articles/5500

Econ Journal Watch,
Volume 3, Number 1,
January 2006, pp 88-94.

INTELLECTUAL TYRANNY OF THE STATUS QUO FOLLOW-UP

Editorial note: The following exchange was solicited after David Altig, Brad Setser, and Kurt Schuler had generated a back-and-forth at Altig's Macroblog. Each part of the following was formulated afresh, to produce an exchange that stands in lieu of that which took place at Macroblog.

Damned If You Do: Comment on Schuler's Argentina Analysis

DAVID ALTIG*

IN THE PREVIOUS ISSUE OF *ECON JOURNAL WATCH*, KURT Schuler (2005) surveys the truly painful travails of the Argentine people around the turn of the millennium, and the expert commentary from U.S. economists. Schuler sees messy footprints.

> Economists whose work in other areas I admire failed to do the research necessary for understanding Argentina's situation accurately. As a result, their analysis was faulty. When Argentina followed the main recommendations of the consensus, the economy's rate of decline accelerated. (235)
>
> A review of what U.S. economists said about Argentina shows that many failed to define key terms in their

* Federal Reserve Bank of Cleveland and Graduate School of Business, University of Chicago.

> arguments; most ignored readily available data that contradicted the consensus view about Argentina's economy; and nearly all neglected to examine the legal and statistical material, available for free online, necessary for understanding how Argentina's monetary system worked. The episode is important because it raises the question of whether the public can trust economists who claim expertise on controversial issues of economic policy. (236-37)

If legitimate, this is a stinging indictment indeed. I am identified as a perpetrator, for a 1999 article I wrote with my colleague Owen Humpage. Schuler lists several transgressions, but this one in particular put Owen and I in the crosshairs.

> Among the 100 most active commentators on Argentina, 91 of 94 who mentioned the topic called the convertibility system a currency board. Yet examination reveals important differences between the convertibility system and an orthodox currency board. The system was a central bank that mimicked some currency board features; it is perhaps best termed a currency board-like system, or even a pseudo currency board. (243)

We are one of the indicted 91. I plead not guilty.

My defense is this: I don't think Owen and I said anything substantially different than what Schuler claims the truth to be. Here is what we actually wrote.

> **Although the new monetary institution created by the Convertibility Law is not a pure currency board,** such an unadulterated arrangement is a useful benchmark from which to begin thinking about Argentina's monetary structure. (2, bold added)

We followed up our description of this "useful benchmark" with a section describing the actual institutional monetary arrangement in Argentina, which we titled "Argentina's Almost Pure Currency Board." Although Kurt complains about the failure of economists (like me) "to do the research necessary for understanding Argentina's situation accurately"

(235), this section of Owen's and my paper (which contains about 15 percent of the article's total word count) was based on the work of a pretty reliable source: Kurt Schuler.[1]

In fact, the central point of our article was that the Convertibility Law contained special non-currency-board-like provisions. Owen and I enumerated the specific ways in which Argentina's monetary institutions departed from a pure currency board arrangement—namely, allowing central bank reserves to be held in non-dollar reserves, standing lines of credit via repurchase agreements with large multinational banks, and provisions to lend dollar reserves to domestic banks—and we offered those departures as a sensible response to critics who claimed that a currency board arrangement was too rigid for Argentina's own good. We did not merely acknowledge the differences between the creation of the Convertibility Law and a pure currency board. Those differences were the heart of our analysis.

This would all be of small moment if my comments here amounted to nothing more than an attempt to salvage my co-author's and my honor. But I think our particular case is symptomatic of a deeper problem with Schuler's analysis. The table that puts Owen and me in the category of terminology-abusers, includes this qualification: "[The authors] occasionally mentioned that the convertibility system was not an orthodox currency board, but on balance seemed to consider the system a currency board." By my count, Schuler grants the same qualification to 39 of the 91 authors who ran afoul of the Schuler get-the-definition-right mandate.[2] I have not gone back and checked each of these 39 cases, but here is a sampling from one of the listed offenders.

> Some critics argue that the convertibility plan was not a meaningful currency board because it did not force strict equality of the money base with external reserves…[I]n the second quarter of 2001 in the face of recession, Minister of Economy Domingo Cavallo boosted the money base in a catch-up to the level of reserves, which had by then eased back to about $20 billion. However, he did not shrink the

[1] Footnote 4 of our article reads as follows: "Steve H. Hanke and Kurt Schuler's 'A Dollarization Blueprint for Argentina,' Cato Institute *Foreign Policy Briefing,* no. 52 (March 11, 1999) provides an excellent review of the Convertibility Law…" We further reference the Hanke-Schuler work in the "Almost Pure" section. From footnote 6: "For a good description, see Hanke and Sculer, op cit."

[2] See Schuler's Table 1, which appears on pages 238-240.

> money base again despite the subsequent plunge of reserves to $10 billion, breaking the tie between the two on the downside. **While the period 1995-2001, and more convincingly 2001, may disqualify the plan from the designation as a true currency board, for at least the period 1991-2000 the system achieved the economic objective of a currency board by providing strong confidence that the national currency would be backed by reserves.** Moreover, it would likely have been a mistake to pursue more rapid money expansion in 1996-2000, aggravating the economic cycle. (Cline 2003, 21 footnote 8, bold added)

Here are passage from another set of authors given bad marks by Schuler:

> In March 1991, Congress passed **the "Convertibility Law", which pegged the peso to the dollar one-to-one, and transformed the monetary and exchange rate functions of the Central Bank into (almost) a currency board**… The Central Bank had to maintain liquid international reserves to cover (almost) 100% of the monetary base (but not broader monetary aggregates), and thus could not increase the monetary base except when international reserves expanded (through trade surplus or net capital inflows) (Díaz-Bonilla et al 2004, 4, bold added)
>
> The supply of liquidity beyond the monetary base was still affected by Central Bank monetary instruments such as the reserve requirements for the banking system and the use of short term swaps. This allowed some room for maneuver in monetary policy. Also **a percentage of the backing of the monetary base could be covered by dollar denominated debt of the Argentine government, which permitted some monetization of fiscal deficits. Hence, the use of "almost" in the previous paragraphs**. (Díaz-Bonilla et al 2004, 4-5, footnote 4, bold added)

And yet another example:

> [Argentina's] economic policies, which were largely the brainchild of President Menem's formidable economy minister, Domingo Cavallo, featured a hard peg of the Argentine peso at parity to the US dollar, backed by the Convertibility Plan, which strictly limited domestic money creation under an arrangement **similar to a currency board**. (Mussa 2002, 1, emphasis added)

You get the idea. In none of these cases is there a failure "to do the research necessary for understanding Argentina's situation accurately." In each instance the special characteristics of the Convertibility Plan are made clear, and the distinctions relative to the strictest interpretation of a pure currency board highlighted. It is true that the generic phrase "currency board" tends to be liberally applied as a substitute for the more unwieldy "currency-board-like arrangement" or something of the sort. But this is a stylistic shortcut that is not the least bit misleading in the context of the articles in question.

In addition, the authors on Schuler's list are apparently in good company when using the "currency board" shorthand in their discussions:

> Although it is true that some analysts referred to the Argentine arrangement as "mimicking" a currency board, it is also true that before the crisis many super-fixers praised the Argentine regime. [Footnote: Kurt Schuler, the author of some of the most serious work on currency boards, included Argentina in his "team of currency boards," in a public wager that he posted on the Internet.] (Edwards 2002, 238)

I'm not sure how accurate that is, but either way it is sort of ironic.

The Schuler critique is serious because he claims that this is not a semantic dispute, but a substantive one: In giving uniformed and misleading descriptions of the Convertibility Plan and the Argentine monetary regime, various authors set back the cause of workable reform. On this particular point, I think the case is not made. Schuler refers to several other "mistakes"—opinions on whether the currency was overvalued, whether exports from Argentina were uncompetitive, whether dollarization was technically feasible. He treats the answers to these questions, the last two especially, as definitive, but it seems to me that there is more room for honest disagreement than the author's views allow.

The advice given by economists may have been good or bad, and the record on that score is well worth exploring. Furthermore, it is hard to argue with Schuler's plea that those who proffer such advice make the effort to truly understand the institutional arrangements (and socio-political realities) with which the targets of their attentions must deal. But my belief is that a close and objective reading of the record will reveal a better score in this dimension than he claims.

REFERENCES

Altig, David and Owen F. Humpage. 1999. Dollarization and Monetary Sovereignty: The Case of Argentina, Economic Commentary, Federal Reserve Bank of Cleveland, 15 September. Link.

Cline, William R. 2003. Restoring Economic Growth in Argentina. World Bank Policy Working Paper No. 3158, June. Link.

Díaz Bonilla, Carolina, Eugenio Díaz Bonilla, Valeria Piñiero, and Sherman Robinson. 2004. Argentina: The Convertibility Plan, Trade Openness, Poverty and Inequality. Typescript. Link.

Edwards, Sebastian. 2002. The Great Exchange Rate Debate After Argentina. *North American Journal of Economics and Finance* 13(3):237-252. Link.

Mussa, Michael. 2002. Argentina and the Fund: From Triumph to Tragedy. Washington: Institute for International Economics. Link.

Schuler, Kurt. 2005 Ignorance and Influence: U.S. Economists on Argentina's Depression. *Econ Journal Watch* 2(2): 234-278.

ABOUT THE AUTHOR

David Altig is a vice president and associate director of research in the Research Department of the Federal Reserve Bank of Cleveland, and is an adjunct professor of economics in the Graduate School of Business at the University of Chicago. He has also served on the faculty of Indiana University, and lectured in economics at Brown University, Case Western Reserve University, Cleveland State University, Duke University, John Carroll University, Kent State University, the University of Iowa, and in the Chinese Executive MBA program sponsored by the University of Minnesota and Lignan College of Sun Yat-Sen University. His email address is: fdaltig@gsb.uchicago.edu.

GO TO SCHULER (2005) ARTICLE ON ARGENTINA

GO TO SCHULER (2006) REPLY

Discuss this article at Jt: http://journaltalk.net/articles/5500