

# Diversification and Macro Policy Coordination Challenges:

An Illustration with the Experience of Argentina 2003-2014

Columbia IPD and Renmin University of China Conference  
Beijing

Martin Guzman (Columbia University)

August 29, 2015

Two big issues:

- Diversification
  - How can natural resource rich-economies escape from Dutch diseases and promote economic development?
- Exploitation of learning spillovers
  - How can they develop non-resource tradable sectors with larger learning spillovers, that also incorporate the labor force in the functioning of the system?

## Role of RER Policies for Economic Development

(Guzman-Ocampo-Stiglitz 2015)

- Challenges
- Illustration: The Case of Argentina 2003-2014 (Guzman-Reyes 2014)

- There are policies for attacking the problem of high macroeconomic volatility associated with low diversification
  - Stabilization funds
  - Countercyclical macro policies (supported by interventions in foreign exchange markets and capital account management)
- But they do not address other fundamental problems:
  - Low labor requirements of those structures of production
  - Limited learning spillovers

- In the presence of learning spillovers, free markets would provide suboptimal solution
  - Under-investment in sectors associated with spillovers
- If those sectors could be perfectly identified, if it was possible to implement direct subsidies, and if there were no political economy problems that affected the determination of subsidy policies, then there would exist a set of taxes, subsidies, and transfers that would be Pareto-efficient
- But if those conditions are not present, there is a role for Stable and Competitive RER Policies

- SCRER policy can enhance economic diversification through two main channels:
  - It makes investment in the tradable sector more profitable
  - It makes investment in the tradable sector less uncertain
- Growing literature shows that long-term growth is positively associated with the capacity to guarantee a competitive exchange rate

- Competitive RER policies also benefit the traditional export sectors
  - Exchange rate policy *alone* may fail to encourage diversification
- Taxes of traditional commodity production (including export taxes) should be part of the policy package
  - Creating *de facto* a system of *multiple effective exchange rates*

- General proposition: sectors with negative externalities or with less learning spillovers should be more heavily taxed
- This tax policy channels the benefits to the right sectors, and generates the revenues for running industrial policies that are complementary of SCRER policies
  - Industrial policies as provision of credit to non-resource sectors (possibly through development banks), investments in infrastructure, education, and R&D, that would increase the elasticity of the aggregate supply to the RER

- To avoid large pass-through from nominal exchange rate depreciation to prices
  - Pass-through elasticity is increasing in the elasticity of substitution between domestic and foreign goods
  - Empirical research shows that pass-through elasticities are increasing in RER volatility

- SCRER must be continued until the infants grow
- Continuity of SCRER requires coordination with fiscal and monetary policies
- Unsustainable macro policies could create inflationary pressures, that would affect RER stability and would make the RER less competitive

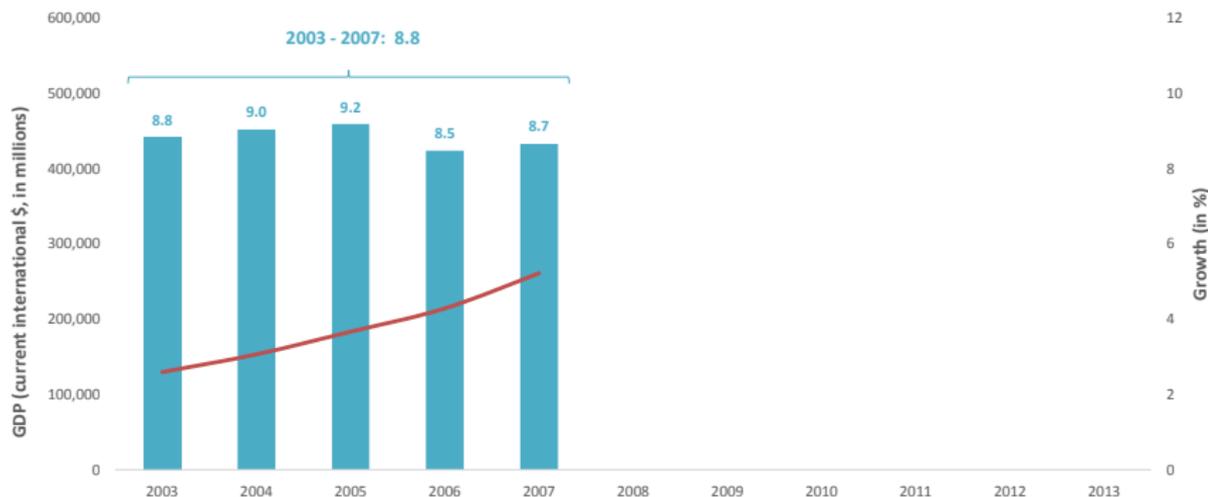
## The economy in 2002

- GDP growth rate: -10.9%
- Unemployment rate  $\approx$  20%
- Utilization of capital  $\approx$  55%
- Large devaluation not followed by proportional pass-through  
→ competitive RER

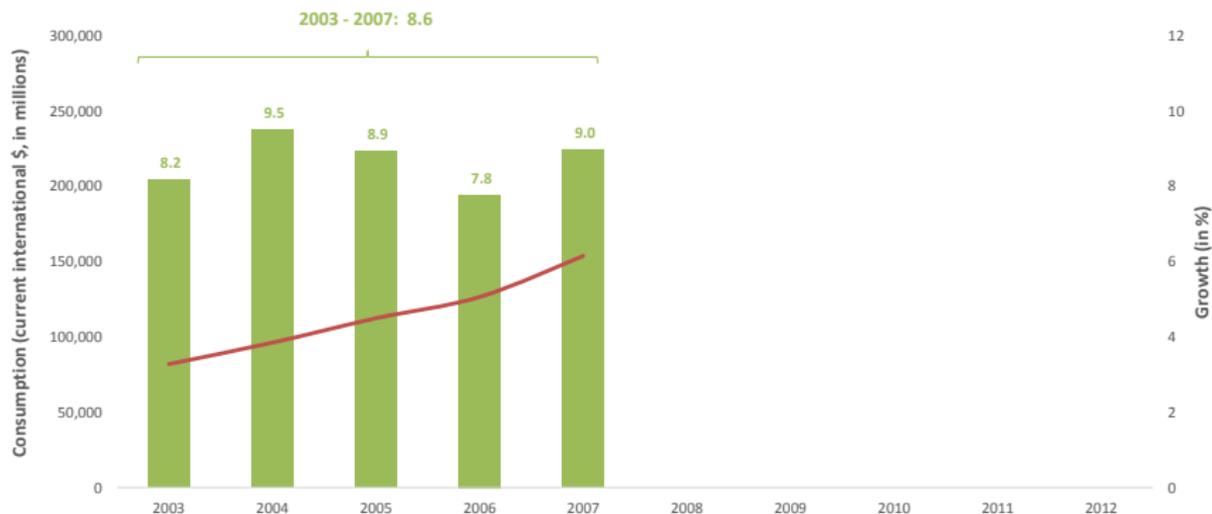
## 2003-2007

- Competitive RER
  - Boosts exports
  - Hence it boosts employment
  - Amplification effects through recovery of aggregate consumption
- Demand-led growth strategy
  - No inflationary pressures due to excess of supply capacity

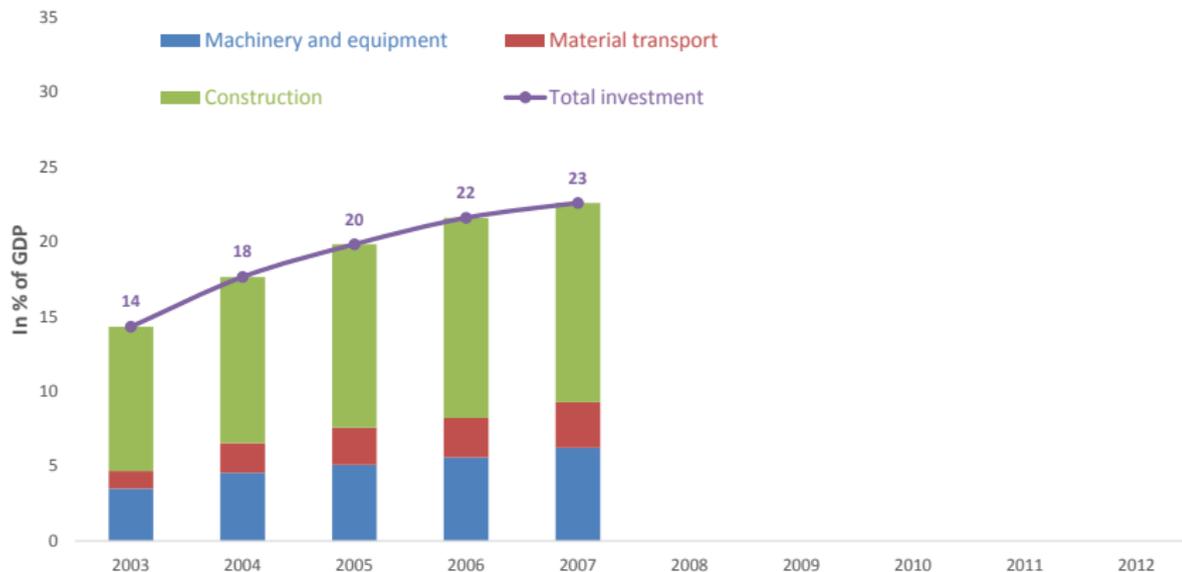
## GDP: levels and growth rates



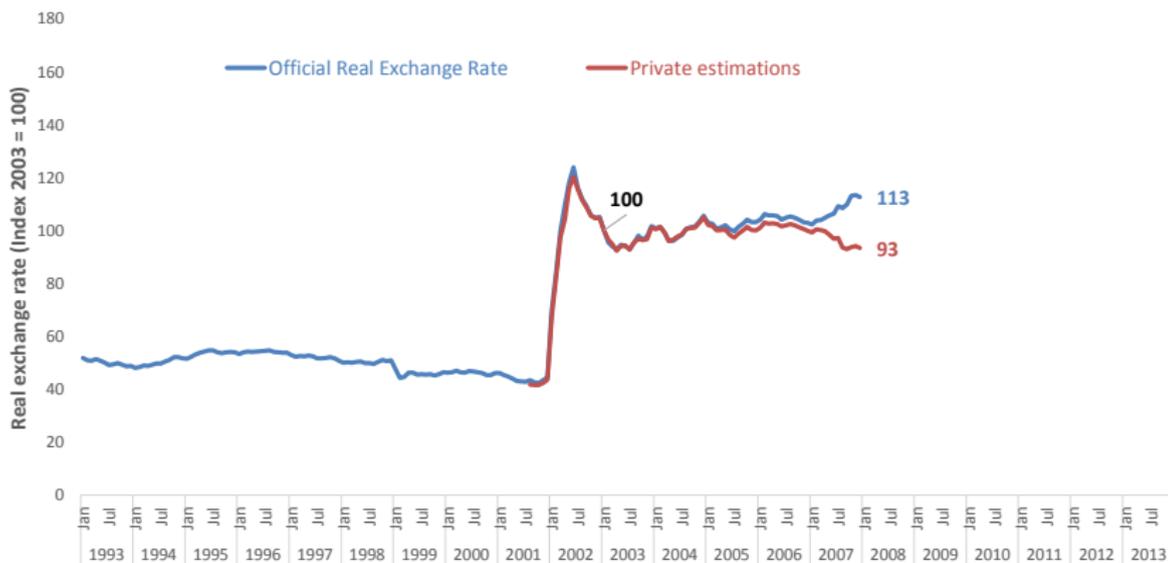
## Consumption: levels and growth rates



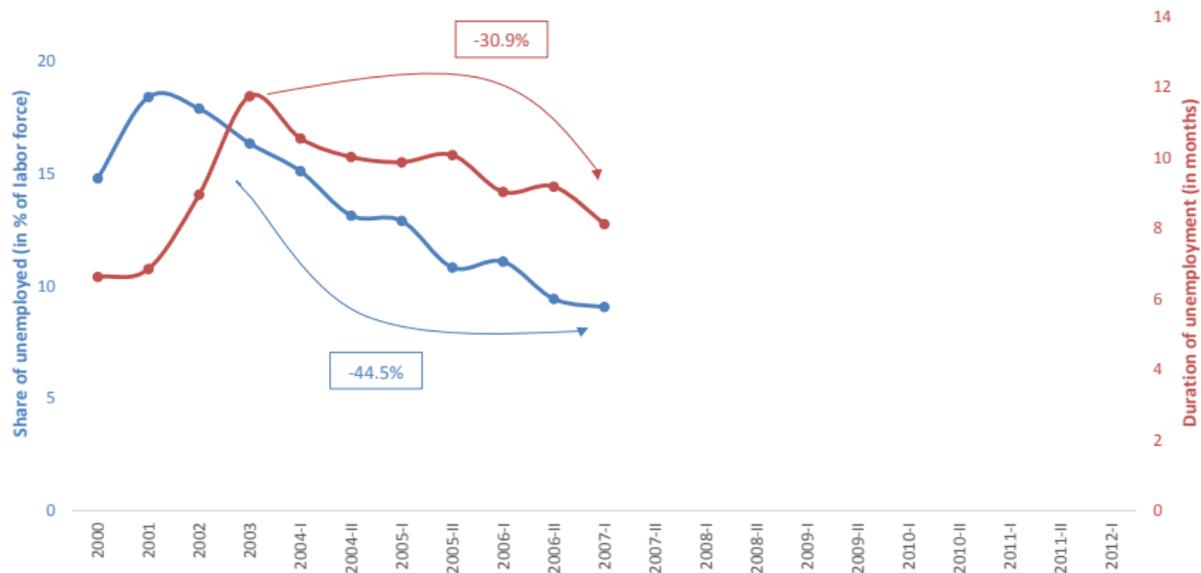
## Gross Domestic Fixed Investment: levels and composition



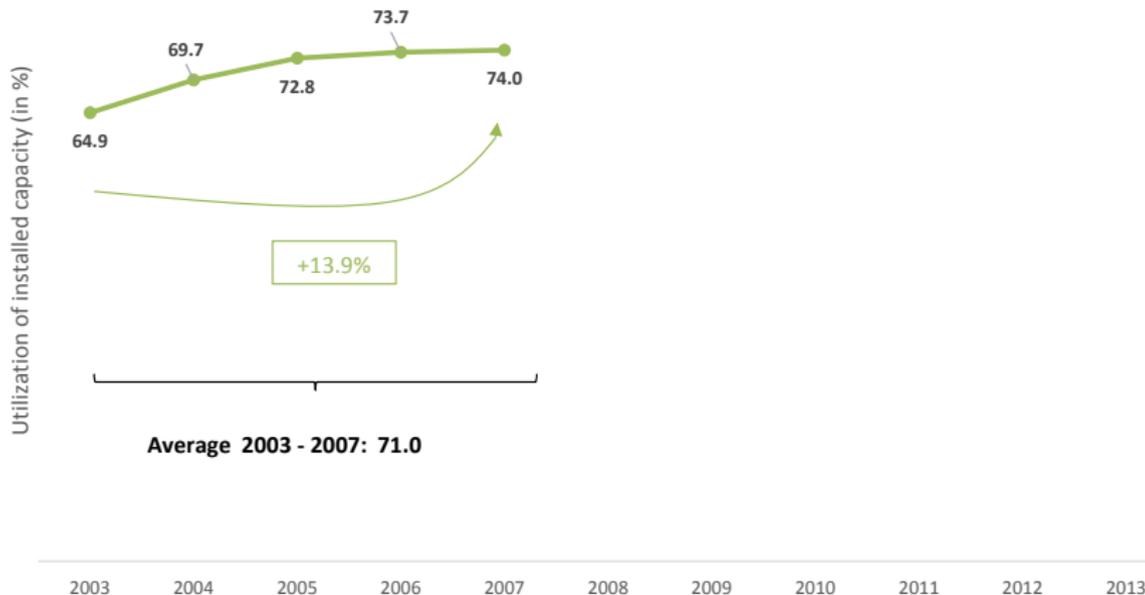
## Real Exchange Rate



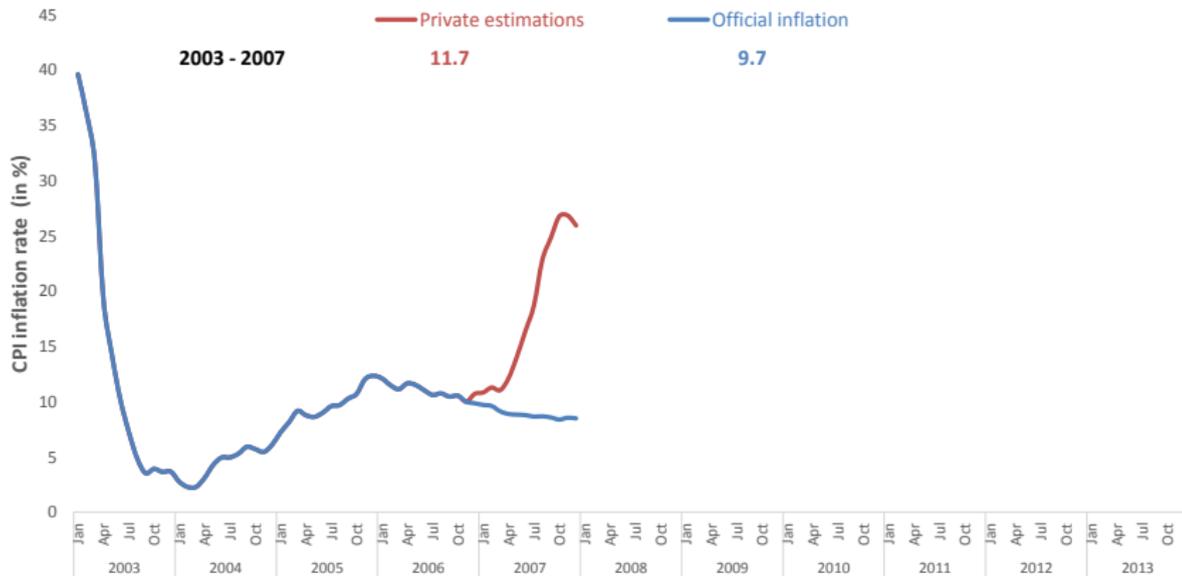
## Unemployment: Rates and Duration



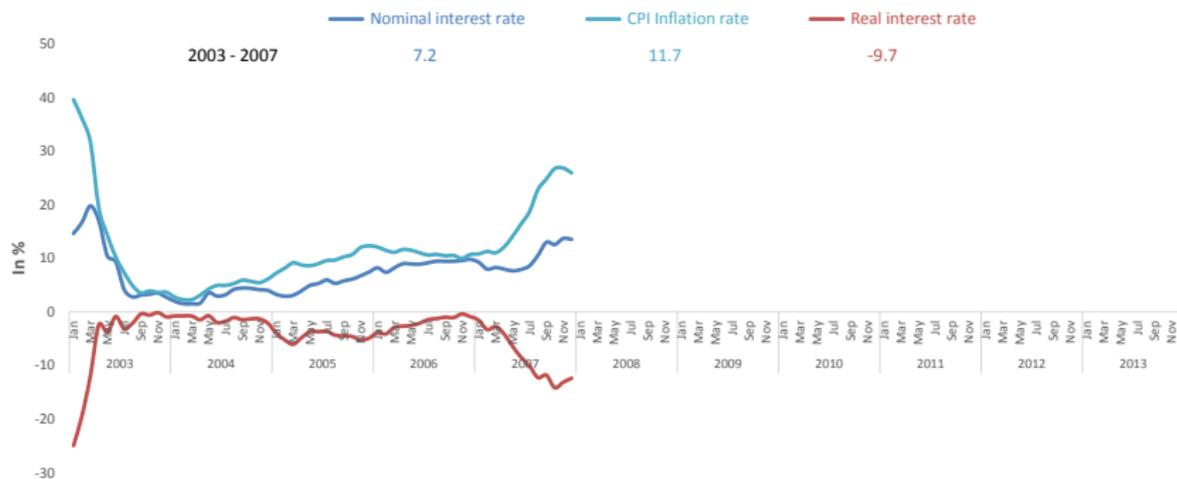
## Utilization of capital



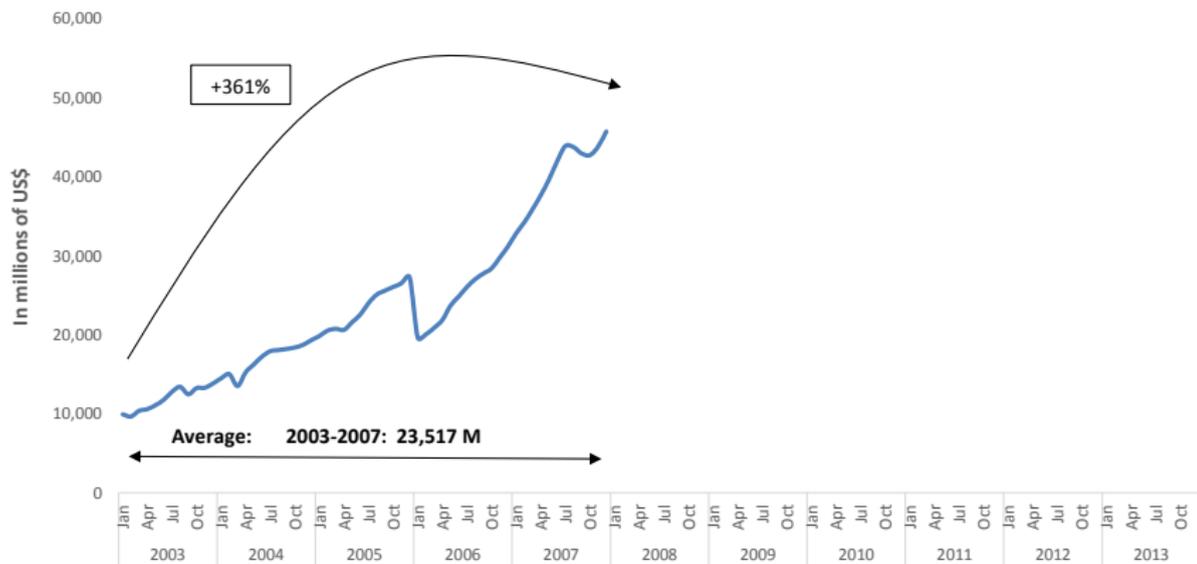
## Inflation



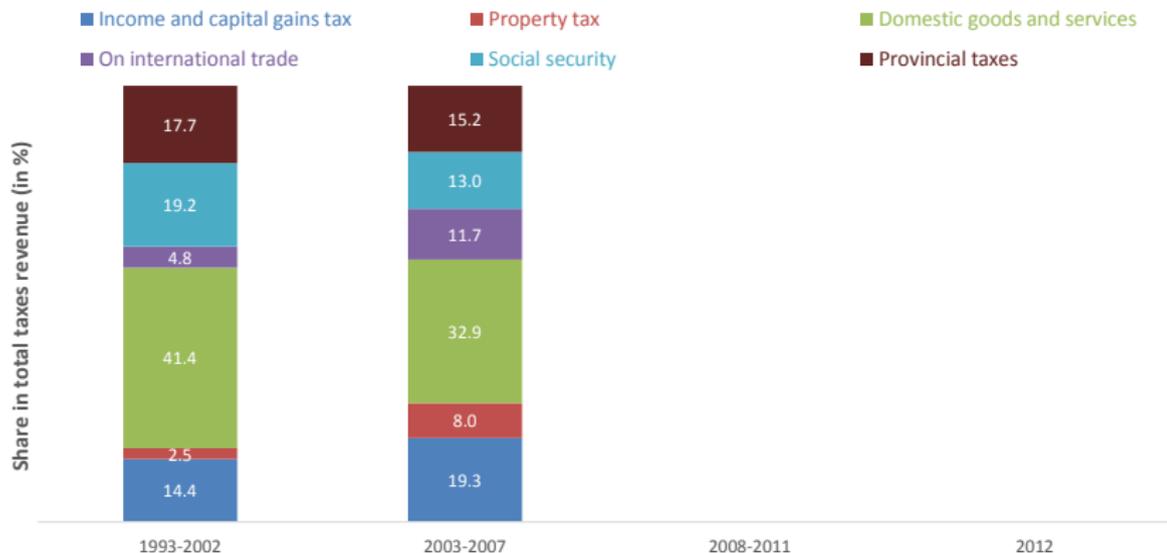
## Interest Rates



## Foreign Reserves



## Composition of Taxes



## 2008-2011

- International conditions get worse (global financial crisis)
- Persistence of demand-led growth strategy
  - Strategy centered on consumption, not investment
  - Common argument from policymakers: demand determines productivity growth (supermultiplier)
  - No evidence in favor of a supermultiplier; if it existed, there would never be a binding budget constraint
- Inconsistencies appear to reveal
  - Looming bottlenecks in energy sector
  - Private capital outflows → Attacked through exchange rate controls
- Exchange rate and public utilities used as nominal anchors

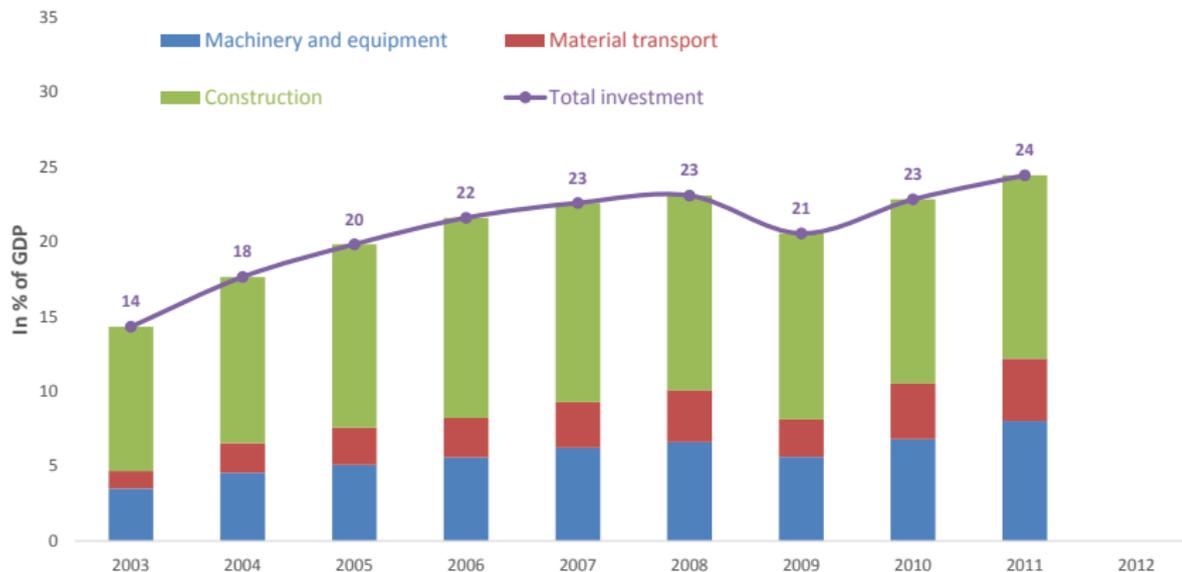
## Evolution of GDP and GDP growth



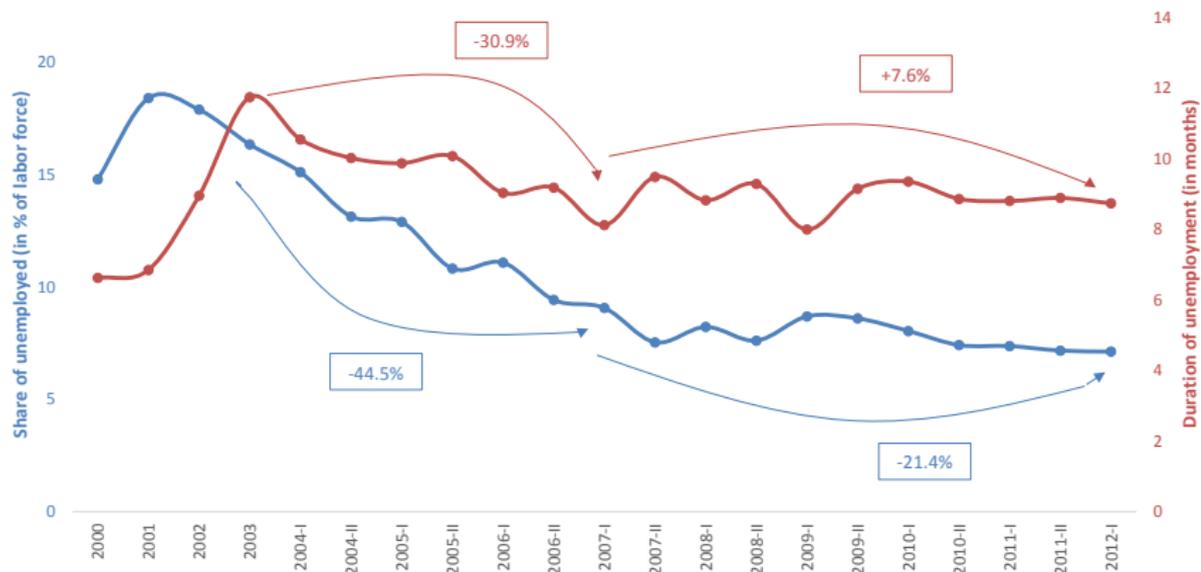
## Consumption: levels and growth rates



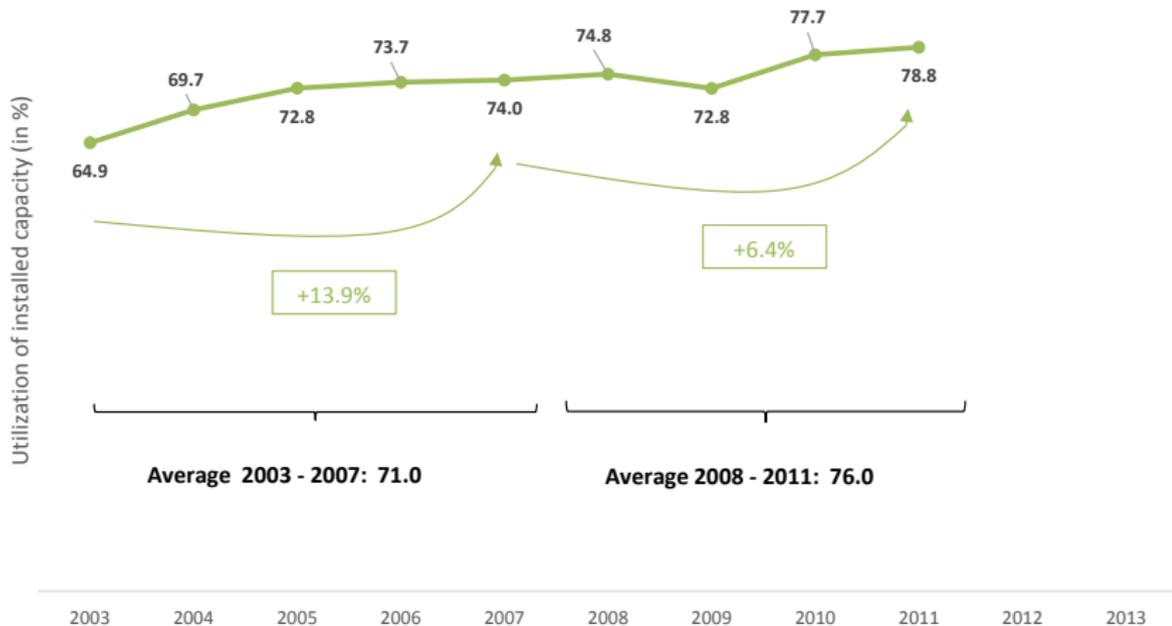
## Gross Domestic Fixed Investment: levels and composition



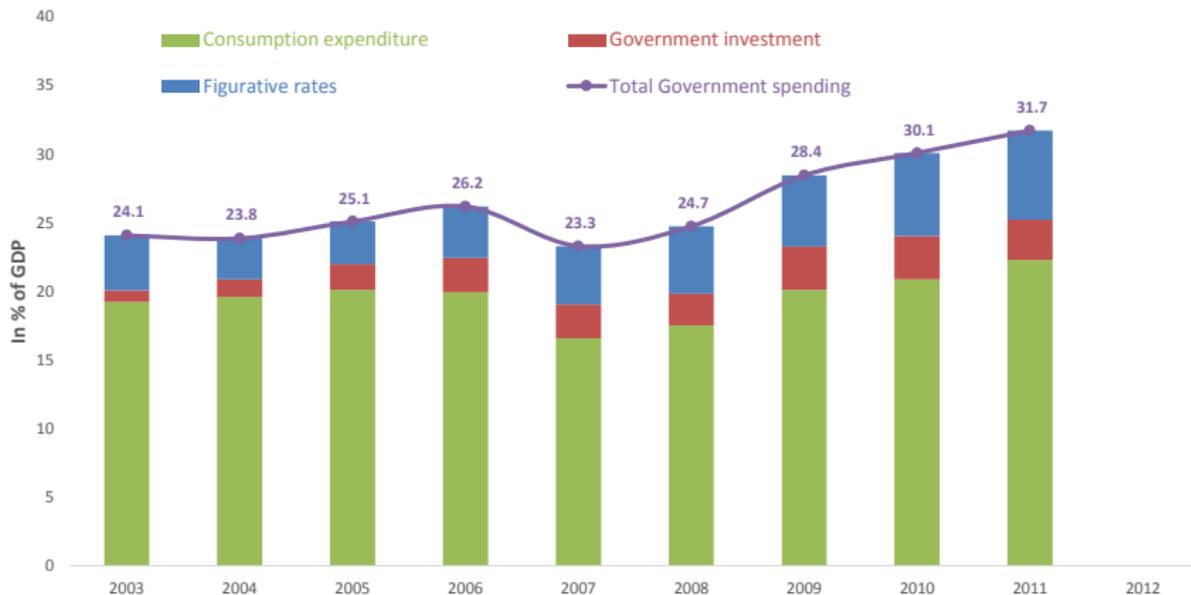
## Unemployment: Rates and Duration



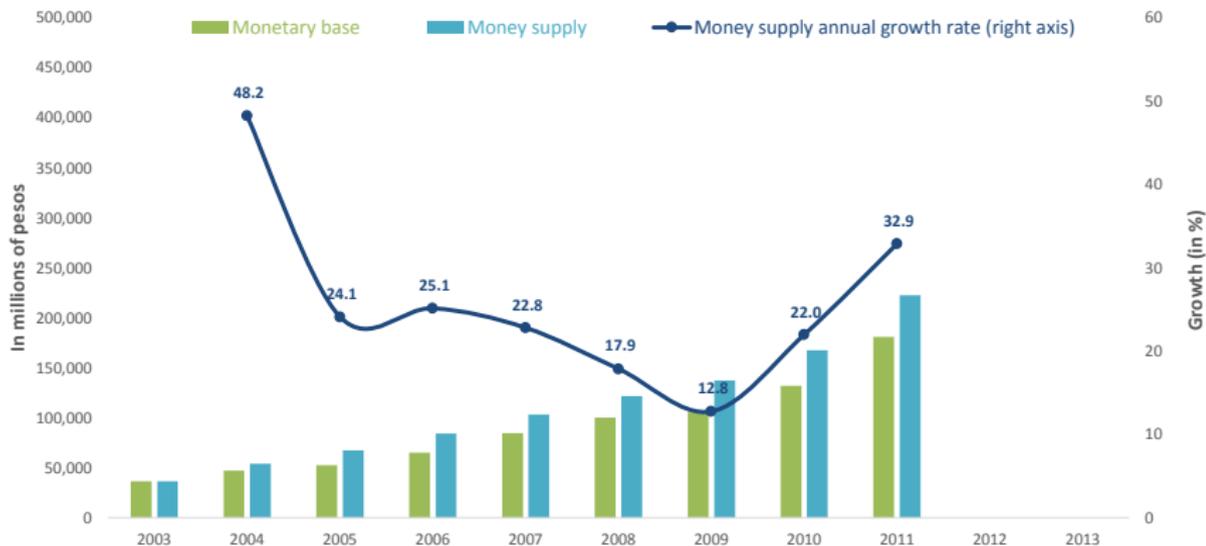
## Utilization of capital



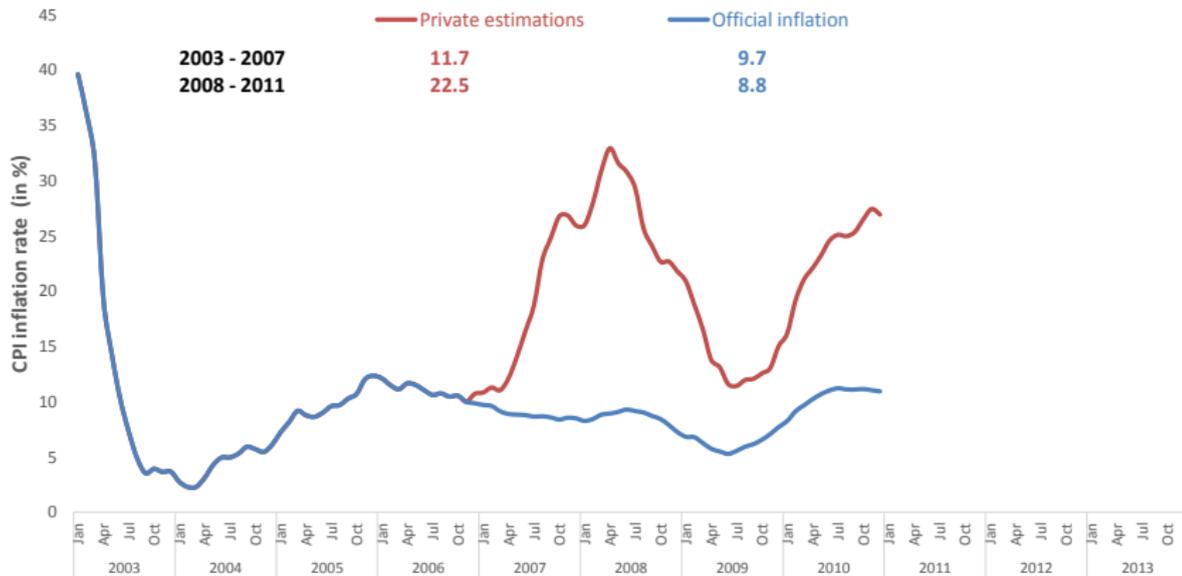
## Public Spending



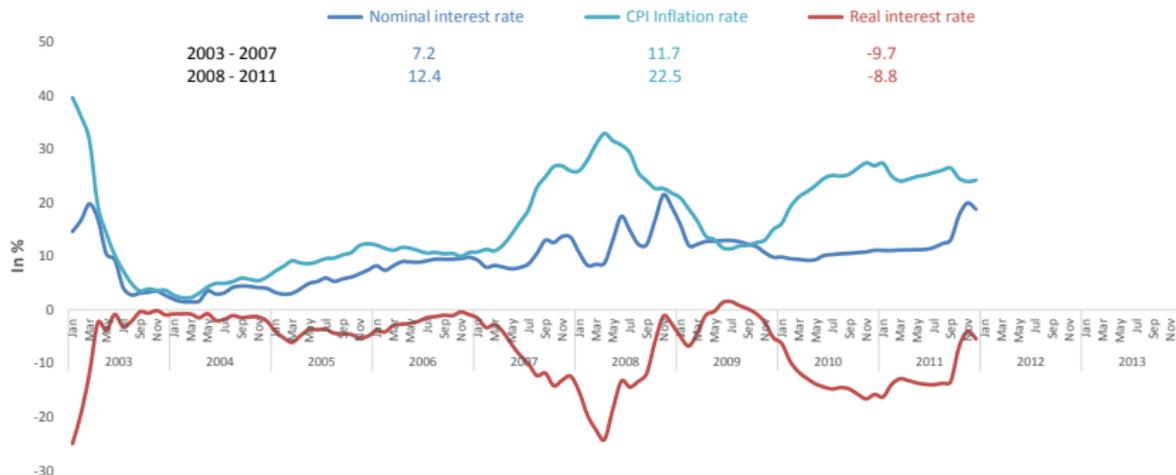
## Money Supply



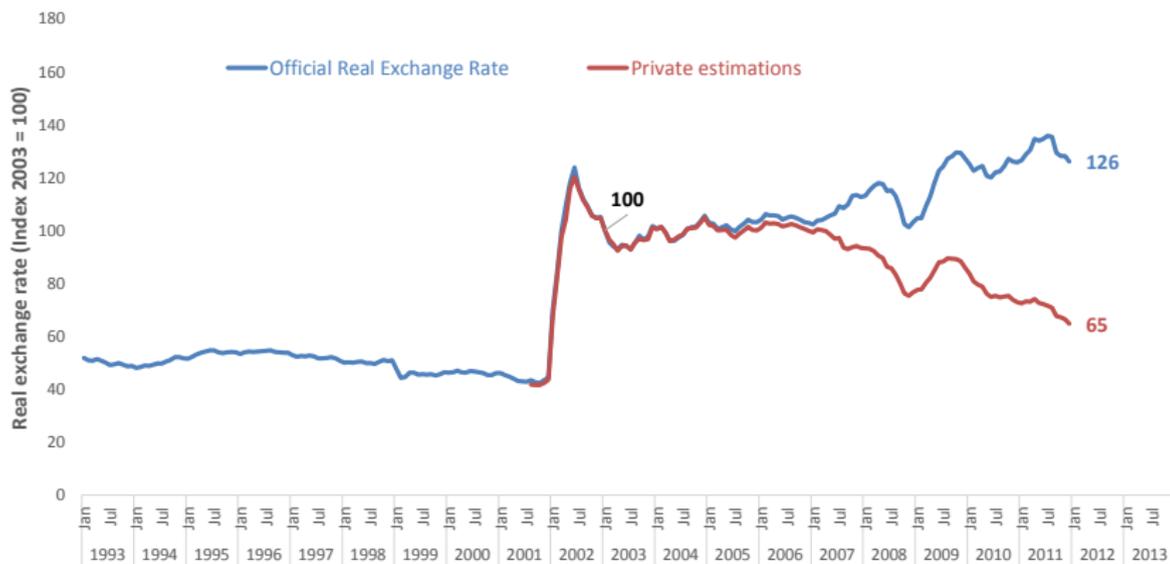
## Inflation



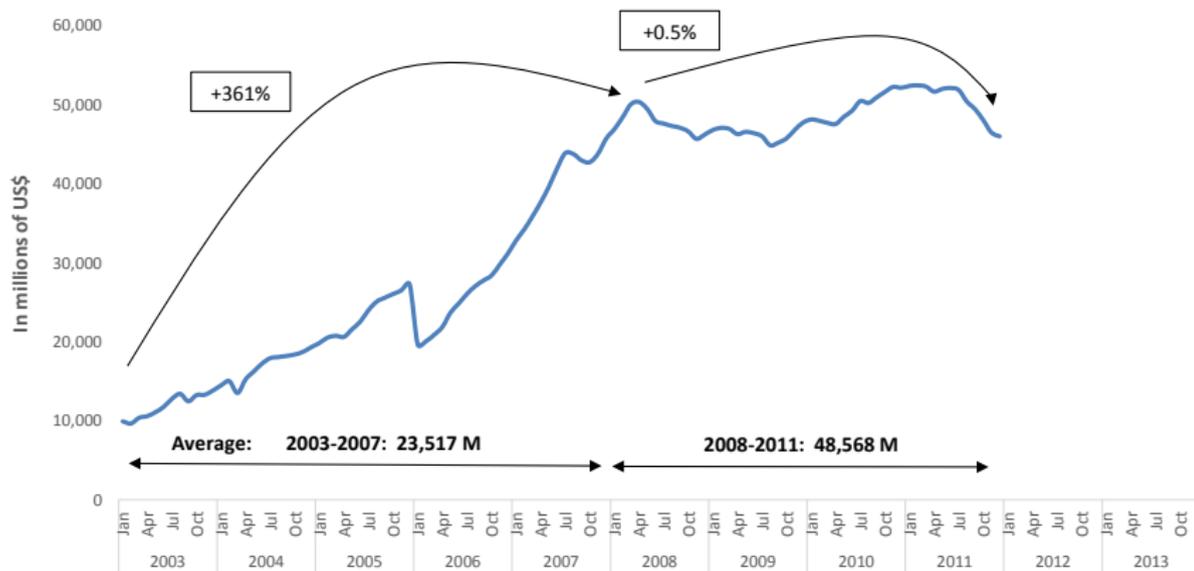
## Interest Rates



## Real Exchange Rate



## Foreign Reserves



## 2012-onwards

- Inconsistencies reveal at increasing pace
- Demand did not create equivalent supply
- Outcomes:
  - Inflationary pressures
  - Real exchange rate appreciation
  - Exports stagnate
  - GDP growth declines
- Overall, no significant structural transformation
  - Economy still not diversified; high dependence on soy beam exports

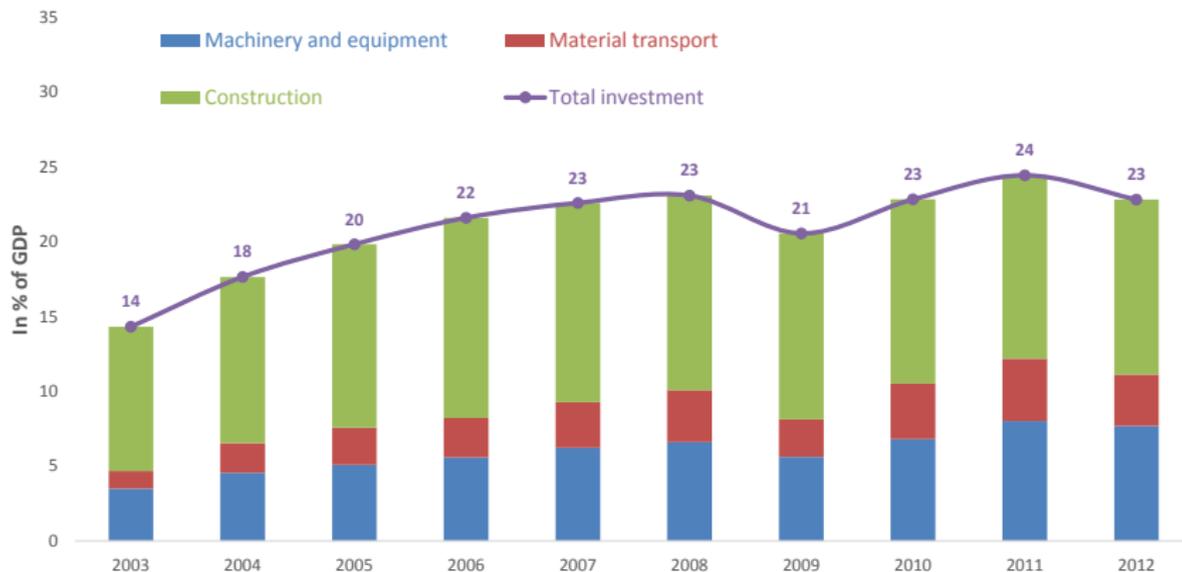
## Evolution of GDP and GDP growth



## Consumption: levels and growth rates



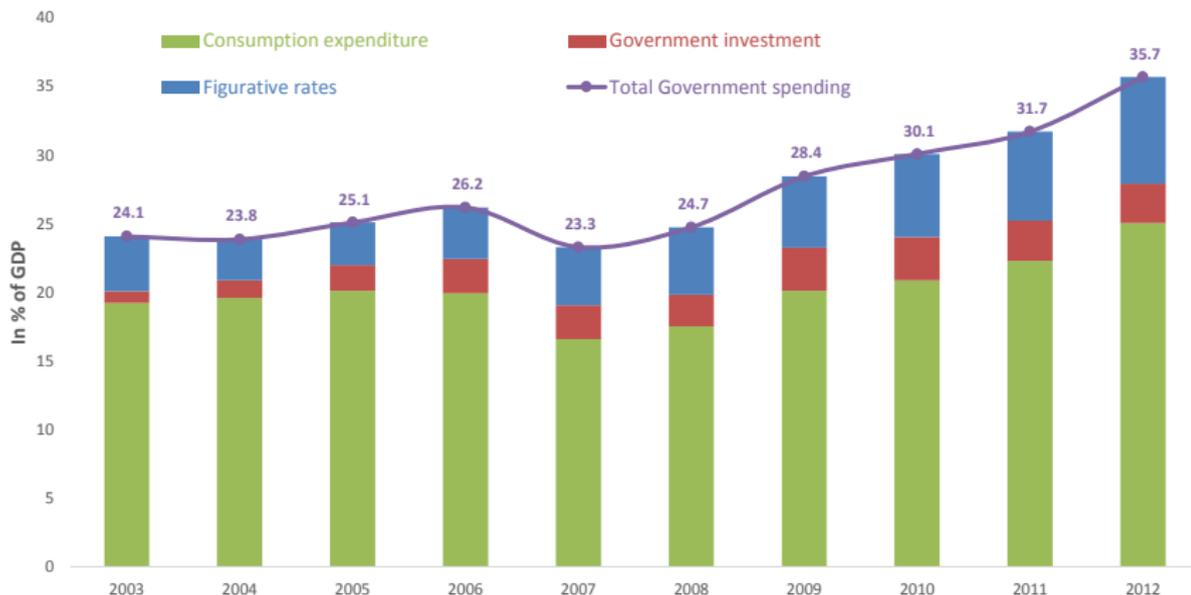
## Gross Domestic Fixed Investment: levels and composition



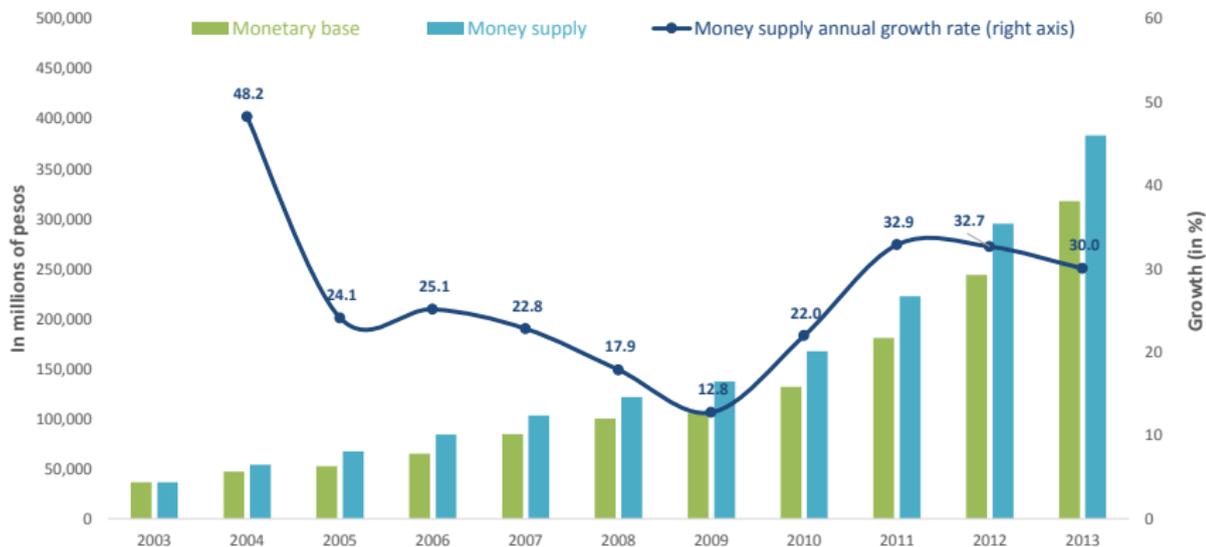
## Utilization of capital



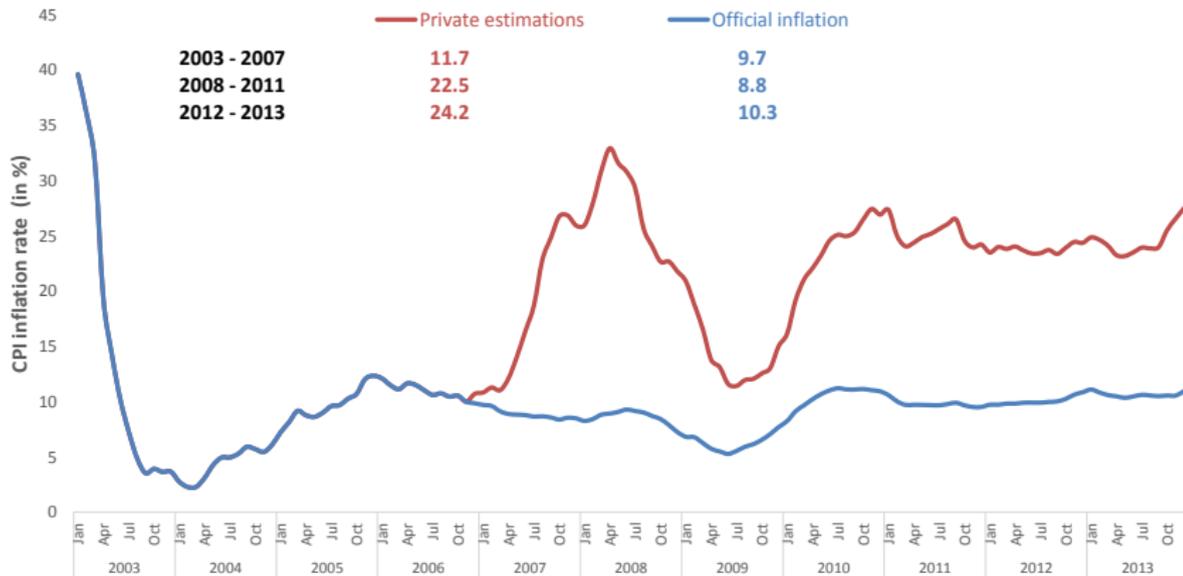
## Public Spending



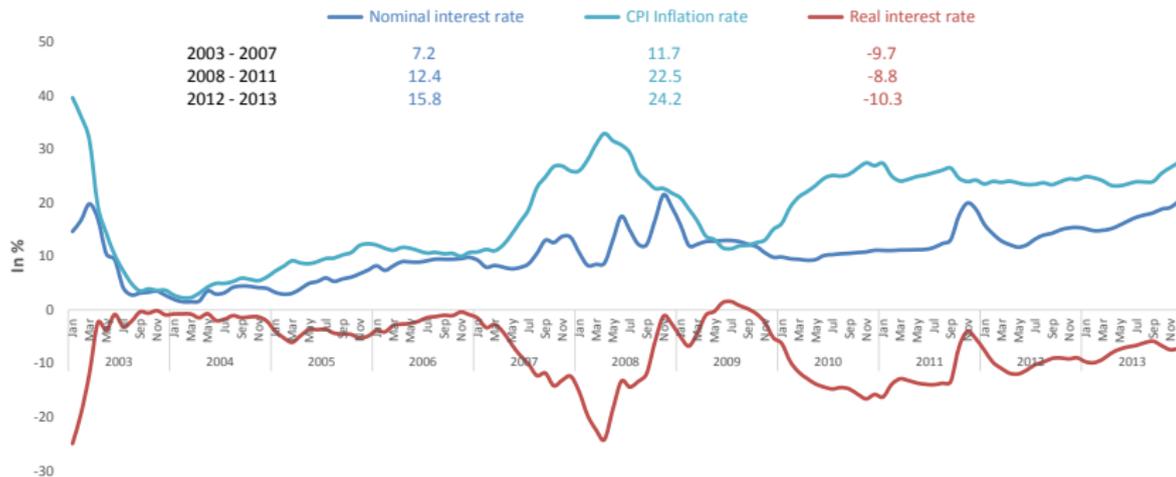
## Money Supply



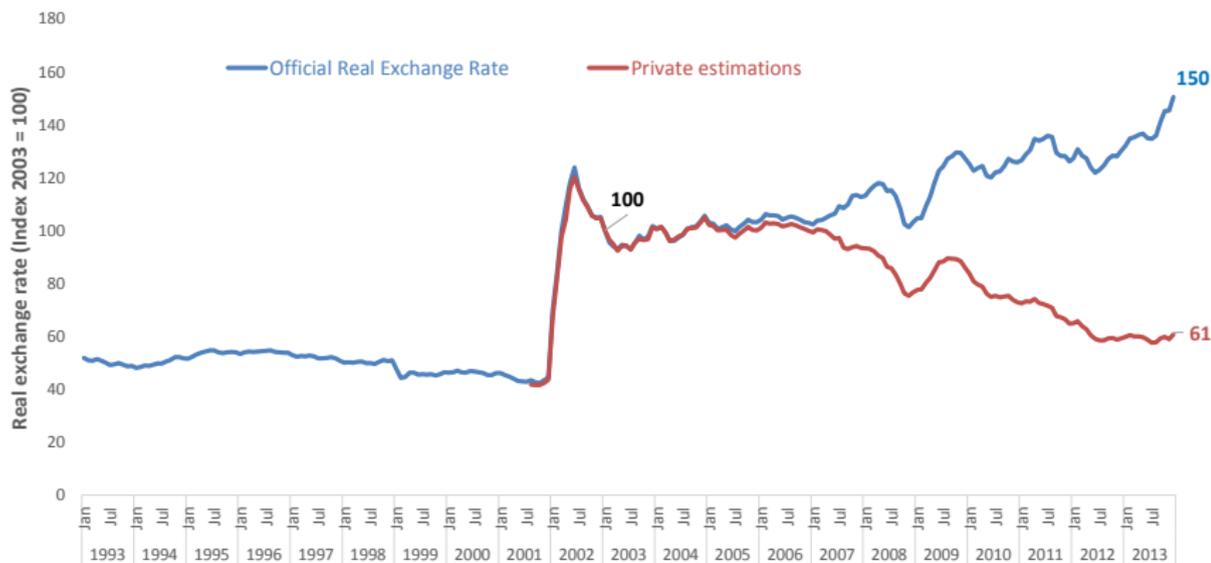
## Inflation



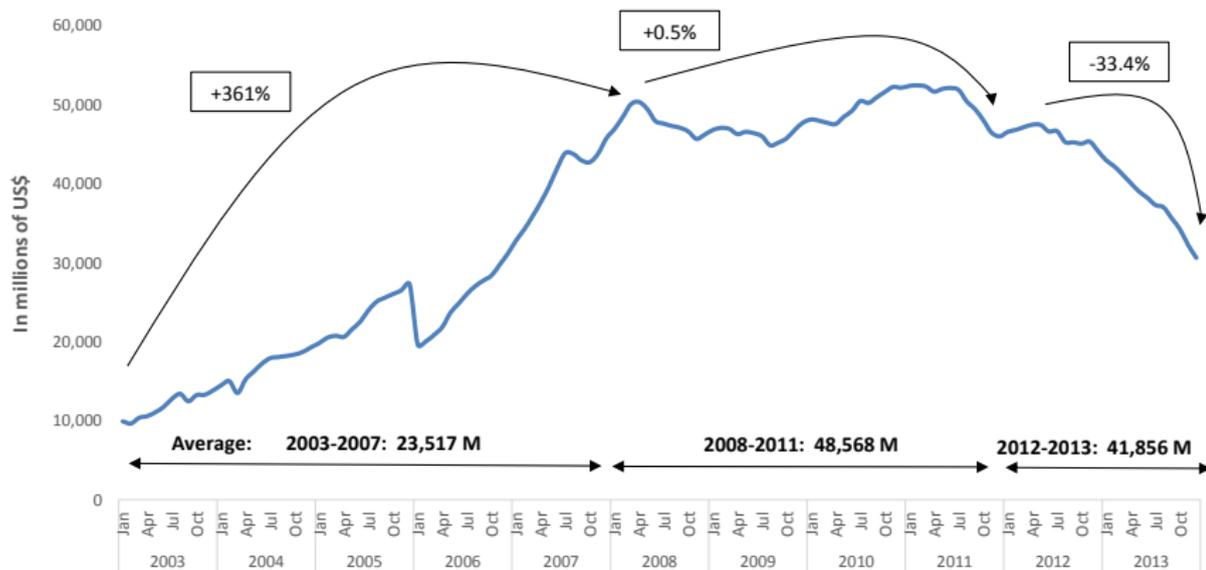
## Interest Rates



## Real Exchange Rate



## Foreign Reserves



## Exports and Terms of Trade



- SCRER sets (some of) the necessary conditions for diversification of the resource sector
- But a successful implementation requires some conditions
  - Coordination with other macro policies is one of them
  - Lack of coordination may impede the continuation of SCRER for the period of time that the infants need to grow
  - The recent Argentina experience is an example of a SCRER that could not be continued