

Exchange rate policy and full employment: lessons from Argentina

Agustin MARIO (Universidad Nacional de Moreno, Argentina)

Introduction: MMT & JG

- MMT: currency issuer* can achieve full employment AND price stability -as defined- with JG (labor buffer stock)
- *with discretionary non buffer stock item spending
- Issuer announces W and hires anyone willing and able to work: full employment+stability of currency`s value (in terms of labor); W is “de facto” minimum
- Critics: “How are you going to pay for it?”; more interesting, economic effects (inflationary+contractive in developing countries, according to some PK`s)

Inflationary and recessive: the presumed channels

- Increase in AD increases imports, the external deficit, international reserves are reduced, forcing devaluation; the devaluation is passed-through to prices (exchange rate inflation), which reduces real wages, shrinking consumption and the economy (recessive devaluation) -until it returns to external balance-
- In developing countries (DC), inflation appears before full employment: “...considerably before they reach full capacity, let alone full employment of the labour force (i.e. developing countries have structural or disguised unemployment), inflation becomes relevant in developing countries” (Vernengo & Pérez Caldentey -V & PC-, 2019:14)

Inflationary and recessive: the presumed channels

- Not new idea; famous PK`s
- Disguised unemployment “is not susceptible to Keynesian remedies, for, if the level of effective demand were boosted up...an inflationary rise of prices would set in” (Robinson, 1949:81)
- “...the general level of output at any one time is limited by available resources, and not by effective demand” and, thus full employment “need not necessarily imply the full employment of labor” (Kaldor, 1957:593)
- “Unemployment and underemployment in underdeveloped countries are of an entirely different nature. They result from the shortage of capital equipment rather than from deficiency of effective demand” (Kalecki, 1960:3)

Inflationary and recessive: the presumed channels

- “...depreciation...resolves the BOP problem, but by throwing the economy into a recession” (V & PC, 2020:6) and “depreciations are inflationary” (V & PC, 2019:15)
- Demand-led growth champions but fiscal policy ineffective (purely inflationary); quantities limited by full capacity/capital equipment
- JG=disguised unemployed

Alternative (to MMT's) policy recommendations

- $CA > 0$: "...the functional finance approach...in the particular conditions of a small and open economy requires to previously generate the conditions for that expansionary demand management" (Amico, Fiorito & Zelada -AFZ-, 2012:90-1); "...it is necessary that exports growth remains above imports, in order to obtain a positive balance on current account" (Amico, 2012:32)
- Borrow US\$ as DC need to import intermediate goods: "...need to import essential intermediary and capital goods that would paralyze the economy if they are not imported" (V & PC, 2020:6); "Industrialization and structural change are necessary, since it is the reduction of the import needs and the boosting of exports that reduces...the...needs...to borrow in foreign currency" (V & PC, 2019:13)
- High i to attract capitals and accumulate international reserves: "High-interest rates were necessary to attract capital flows and accumulate international reserves" (V & PC, 2020:12); "Developing countries might be forced to have higher domestic interest rates to preclude capital flight. Still, it is possible to do expansionary fiscal policy...unless the BOP constraint was reached" (V & PC, 2020:11)

Do we need a CA surplus? MMT and external constraint

- “A country can run a current account deficit so long as the rest of the world wants to accumulate its IOUs. The country's capital account surplus “Balances” its current account deficit...We can even view the current account deficit as resulting from the rest-of-the-world desire to accumulate net savings in the form of claims on the country” (Wray, 2012:140-1)
- “This would imply that any country with a full sovereign currency and no promise to convert at a fixed exchange rate could access unlimited external credit” (AFZ, 2012:89); “MMT economists consider current account disequilibrium as irrelevant” (Fiorito, 2012:107)

Do we need a CA surplus? MMT and external constraint

- Imports=real benefit (only reason to trade); exports=real cost (cost of imports)
- Imports limited by exports+ROW's savings desires of domestic IOUs (no matter what they are denominated in)
- Goal: maximize real terms of trade ($M-X$ given ROW's savings desires of domestic IOUs)
- Problem with $CA > 0$ goal=export-led growth (9th myth?): not every country can be net exporter simultaneously (for every net exporter, there is a net importer); "races to the bottom"
- $CA > 0$ associated with depreciated exchange rate; floating does not necessarily imply depreciation (e.g. Argentina after ending currency board)

Do we need a CA surplus? MMT and external constraint

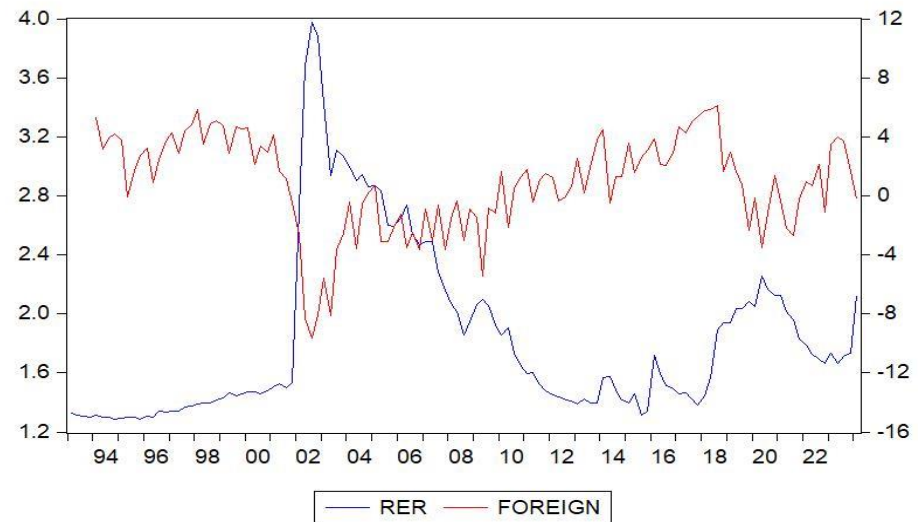
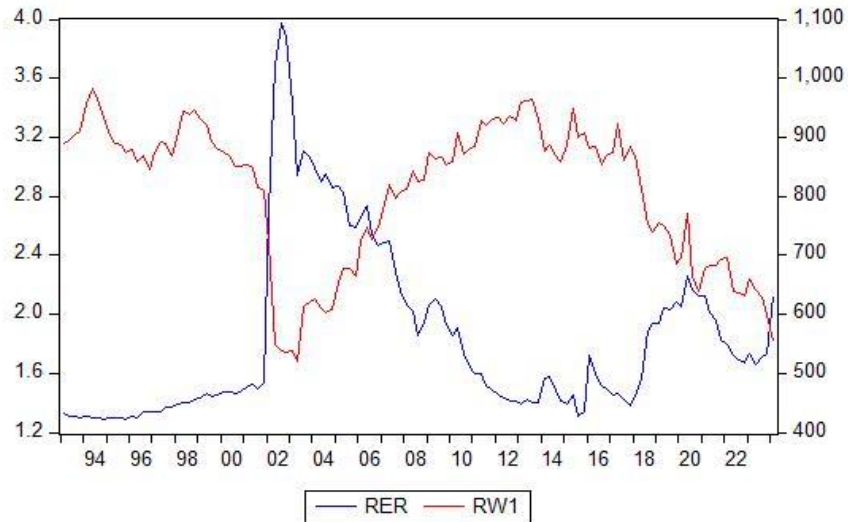
- Floating exchange rate not “unlimited external credit” but “resolves the BOP problem”
- Balances balance: if ROW no longer wants to net accumulate domestic IOUs, exchange rate would depreciate, reducing Y and M
- External constraint=a country may not be able to import all that it wants
- Surprisingly, critics advocate an appreciated and stable exchange rate: “exchange rates, everything else constant, are inversely related to real wages, and, in part, the higher rate of growth during the...ISI period...could be associated to the combination of appreciated exchange rates, which also allowed for cheap imports of machinery, and higher real wages” (V & PC, 2020:7)

Do we need a CA surplus? MMT and external constraint

- “Flexible rates are both inflationary and contractionary, and the exchange rate has distributive effects, that may imply that under certain conditions a stable and appreciated exchange rate could be conducive to higher growth” (V & PC, 2020:13)
- Floating not necessarily inflationary (as we saw, it could appreciate the currency and be deflationary)
- Exchange rate=distributive variable (so is unemployment!)

Do we need a CA surplus? MMT and external constraint

- Inverse relation RER-RW
- But, also inverse relation RER-FOREIGN
- High RW, appreciated/strong currency, cheap and abundant imports is desirable but external constraint



Do we need high interest rates?

- What is high?: $i=i^*+p+e$ “ i competes with international interest rate+EMBI/risk premium+expected devaluation”
- $p=0$ in own currency; e not explicit (if exchange rate depreciates/reserves are loss, it could always be argued that e was higher)
- Does not work under rationing (not explicit); if i hikes work to appreciate/accumulate reserves, rationing in the FX market would not make sense
- MMT: bond sales after spending by issuer; i exogenous/policy variable; natural/normal/risk free=0
- Even if $i>g$, issuer can always pay; what matters is the effect of interest rate policy

Do we need high interest rates?

- “Liquidity preference” assumed to prevail (substitution/arbitrage effect between alternative assets): higher i presumably reduces demand for U\$ dollar
- Income effect ignored: interest income channel (more important, the higher the public debt; 146% of GDP in 2024q1); higher i beyond real savings desires increases demand for U\$ dollar (“put out a fire with gasoline”)
- Interest rate policy sustains inflations
- i =distributive variable: positive i is regressive (basic income for those who already have \$ and in proportion to how much they have)
- Expenditures in i =16.8% in 2024q1 (down from 25% in 2023q4)

Do we need foreign currency public debt?

- Public debt in U\$=policy option that may allow to increase imports (and real wealth)
- As V & PC (2020:13) recognize, to keep it under control exports must grow faster than the interest (exports are exogenous so “sustainability” cannot be guaranteed)
- Issuer of \$ can buy whatever is for sale in exchange for \$: if the U\$ has a price in \$ (exchange rate), it can buy it and pay the debt
- But spending would not be price-constrained (no price-rule); inflationary risk (quantity cannot be restricted; non JG spending not discretionary); hyperinflations associated to foreign currency debt crisis
- Public debt in U\$ incents to fix the exchange rate (price rule to avoid hyperinflation) and, thus, implies unemployment; forces an inflation/unemployment trade-off; usually comes with adverse “terms and conditions” (however, Argentina has not pay 1 dollar back to the IMF yet+conditions continuously redefined)

Do we need foreign currency public debt?

- “The naive conclusion is that debt in foreign currency can be completely avoided. The argument is akin to suggesting that breathing in an environment that is polluted is not necessary, just a decision, even if one lives next to a polluting factory and is too poor to move” (V & PC, 2022:2)
- Useless metaphor: possible to import (and grow) without U\$ debt
- “something that no economist from a developing country would have written” vs. “Defenders of national development must affirm the sufficiency of their own resources to overcome the crisis and grow. The others, we already know, are the preachers of Argentine impotence and the inexorable need for foreign capital and the international market as pillars of accumulation and growth” (Ferrer, 1983, preface)
- External constraint: no matter how needed they may be, imports are limited by exports+ROW savings desires

Is full employment inflationary and contractionary?

- JG=labor buffer stock=price constrained spending (price rule); no inflation/deflation; relative prices can change and be reflected in price indexes (PI) variations
- If JG is opposed for increasing a PI, every AD increase that implies some price adjustment should be opposed (e.g. McDonald's)
- JG=countercyclical automatic stabilizer: sustained full employment through business cycle, even if the exchange rate depreciates (and the depreciation shrinks the economy); if employment falls, the size of the JG increases automatically, putting a floor to the recession/wages (and, viceversa)

Is full employment inflationary and contractionary?

- If capital equipment/U\$ are necessary to create jobs, jobs with no/little capital not productive/genuine
- Assuming society must take care of all, even if capital equipment is fully employed - by the number of workers as dictated by non-obsolete techniques-, any production level is better than zero
- PK's forgot that, with unemployment, even wasteful expenditure enrich the community: "if the education of our statesmen on the principles of the classical economics stands in the way of anything better"; "If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disuse coal mines which are then filled up to the surface with town rubbish, and leave it to private enterprise...to dig the notes up again...there need be no more unemployment and, with the help of the repercussions, the real income of the community, and its capital wealth also, would...become...greater...It would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would be better than nothing" (Keynes, 1936:115)

Is full employment inflationary and contractionary?

- Misleading to say “depreciations are contractionary” when depreciation would be caused by the JG (which increases M and Y)
- Curious to find PK`s/demand-led growth authors arguing that autonomous spending would shrink the economy

Concluding remarks

- MMT does not rule out or consider irrelevant that a PI could increase before full employment
- More recently, JG no longer consider “problematic as an employment generating tool” (V & PC, 2022:3); step forward: JG workers no longer considered “disguised unemployed”
- External constraint no longer implies a (natural?) rate of unemployment; unemployment no longer anti-inflation tool (and employed labor buffer stock superior to unemployed)
- JG=jobs-led growth (can/should be complemented by other policies)
- Unemployment functional to growth=only reason against JG
- Unemployment to protect real/U\$ income of those who already have incomes not best policy option

Concluding remarks

- “The implication is that the buffer stock of unemployed serves a dual role -to stabilize the inflation rate and to stabilize the current account position...A further implication...is that the deprivation suffered by those in the buffer stock of unemployed is required to allow those currently in employment to enjoy an array of attractive and relatively cheap imported goods and services. The optimality of this position is not established in economic theory. It is illogical to maintain a costly buffer stock of unemployment in order to keep the exchange rate overvalued. If the exchange rate is overvalued and requires low import demand for stability, then increasing the income levels of those currently unemployed may promote depreciation...the fully employed economy would be structurally quite different to the current sectoral composition...real incomes of those not unemployed...would be lower and those of the current unemployed higher” (Mitchell & Mosler, 2002:256)
- For the unemployed, the JG is a relatively infinite increase of income

THANK YOU!!!
@agustinmario82