

JUAN MIGUEL RODRÍGUEZ LÓPEZ

Independence in Crisis



The Argentinean Central Bank and their accountability
for bureaucratic and political decisions, 1991-2007



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Preface

The primary idea for this work began as I was working as an assistant to Prof. Barbara Fritz, on a project about the control of capital in Latin American countries. The traditional economics I learnt during my first degree did not adequately explain the behavior that we observed. Trying to catch up with some theoretical developments, I began to research the political economy of monetary policy. It was in this process that I realized that there is a significant gap in the literature; whereas there is a very developed understanding of the political economy of fiscal deficits, we have no solid conception of political economy in monetary matters. The proximity of the Argentinean crisis of 2001-2002 and the large amount of literature on central banks motivated me to engage in the challenge presented by this gap, and make a contribution to the construction of the political economy of monetary policy. The historical character of the existent analysis brought the idea of the need for a systematic analysis that I could adapt from the more developed literature on supreme courts.

For the funding that allowed me to pursue this work, I am especially grateful to the International Department of the University of Hamburg for their grant as an international student with remarkable potential (Leistungsstipendium 2008-2009). The years before, I enjoyed working in different projects and for various professors at the University of Hamburg that gave me the opportunity to work, research and discover the intellectual life of the German university. I wish to thank Prof. Michael Th. Greven, Prof. Gabriele Klein and Dr. Markus Stobrawe for the confidence they have shown in my work.

This work has been further improved and refined in the course of presentation in the different colloquiums at the University of Hamburg, and I offer my special thanks to Prof. Manfred Holler and the participants of the Adam Smith seminar and the colloquium for PhD candidates at Department of the Government (University of Essex). The men and women of the Gentleman's Table and Pferdestall-Salon at the University of Hamburg deserve further clear recognition and thanks, both for their friendship and their open-minded methodological pluralism. In particular, I thank Jacob Ole Nestingen, who also helped to better this written version. All errors are my sole responsibility.

An important impulse for this research was its presentation in international conferences. As a postgraduate student, I could secure access to the ideas, networks and panels in Central Bank Independence (at the World Public Choice Congress - Amsterdam 2007 / the European Public Choice Congress - Jena 2008) and Institutions, Actors, and Outcomes in Latin American Political Economy (at the Midwest Political Science Association Conference - Chicago 2009 and 2010). I learnt the strengths and weaknesses of my work every time I presented it and I am especially grateful to the institutions that funded these presentations (the University of Amsterdam, the Deutsche Forschungsgemeinschaft, University of Hamburg and the Midwest Political Science Association).

During this research, I have been fortunate to have been extended the hospitality of two additional universities. I wish to thank Prof. Omar Chisari and his colleagues at the Institute of Economics - Universidad Argentina de la Empresa, for the possibility to complete my field research (Argentina September - December 2007) and Prof. Tod Landman of the University of Essex, for providing me his warm hospitality as an invited PhD student during the final stages of writing (United Kingdom spring term and summer school 2009).

In particular, I wish to thank my parents for their constant support of this research and my adventures as a Latin American student in Europe. Finally, I would like to thank my friend Rolf Kuppler for helping me in my misadventures as a Latin American student in Europe.

Introduction

Central bankers like the idea of low inflation, but their actions have a distribution effect of richness. Monetary policy has a powerful allocative capacity, and its mismanagement can win or lose elections [Lohmann, 1992]. Research on the independence of the central bank dominated the financial literature of the 1980s and the beginning of the 90s. This idea however, that elected politicians decide upon policies and the bureaucrats carry them out, does not explain the behavior of the nonelected central bankers responsible for monetary policy. This investigation researches the separation between bureaucratic and political actors. The use of bureaucratic power for political self-interest is one of the worst outcomes associated with mismanagement. According to Alesina and Tabellini (2007, p. 196), the central problem which leads to such abuse is the limited accountability of bureaucratic behavior. Therefore, this research studies the accountability of a central bank's behavior. This work does so by analyzing the research question, of when the members of the Argentinean Central Bank (the Directorship) have likely changed their position, from a supporting to a defeating the Government's policies between 1991 and 2007, and why.

This book addresses the old problem of the interplay between a central bank and its government using a new approach. This approach is the result of accounting for the strategic behavior of the actors, referred to herein as strategic behavior. It overcomes the assumption that the actors behave in a sequence of causes and subsequent effects. Strategic behavior captures the logic of the inter-temporal conflict of interest that drives the Argentinean Central Bank's behavior.

The Central Bank faces an inter-temporal conflict of interest between the Government and its opposition. The Argentinean Central Bank is under constraint because their independence is never absolute [Bernhard, 1998]. Each Government begins with a new policy agenda, for which they were elected and due to which their political project enjoys popular support. At the beginning of their mandate, the Central Bank decides to support the current Government. However, by supporting the current Government the Central Bank simultaneously increases the likelihood of its being sanctioned in the future, when the

future incoming government is assumed to be today's opposition. Alternatively, the central bank can decide in accordance with the opposition party (defeating the current government), which then increases the likelihood of its being sanctioned by the current government. The central bank is thus in the middle of the action, determining whether they face either current or future constraints.

Governments are generally in charge of monetary policy, which they delegate to central banks, but they always maintain the ability to dismiss bankers. The central bank thus maintains a relevant decision-making role conducting monetary policy, but under constraints. The 90s were a time of transformation for central banks around the world. Since then, more than 90 countries have changed their legal orders in an effort to establish more independent central banking [Maxfield, 1997]. An interesting question is what the central banks have done with their independence. In order to analyze this question, this research has chosen the Argentinean Central Bank as the object for its research. This selection is based on that bank's tradition of deviant cases (for details about this feature, see e.g. Cukierman (1992), Dreher (2006)). during the period of international comparison. The annulled ability of the Bank to issue money as well as Argentina's fixed exchange rate policy have limited the role of its Central Bank to the regulating of financial markets since 1991. This has made their rulings during the period a clear indicator of what the Central Bank has done to support and/or defy the Government. The Argentinean presidential system furthermore allowed for the splitting of time between re-elected and not re-elected Presidents, so that analysis of the comparative differences of the periods is possible. Thus, one of the most important contributions of this research is the evidence that the Argentinean Central Bank systematically played a more important political role than the literature on the currency board in Argentina has suggested (for the literature about the role of the Argentinean Central Bank, see Caprio (1996), Gurtner (2002), or Fischer (2005)).

This research looks at the systematic political behavior of the Argentinean Central Bank and its accountability for its behavior. Policy analysis research has detected interdependency between the Government and the Argentinean Central Bank. The qualitative empirical evidence [Machinea and Fanelli, 1988, Kiguel, 1991, Marengo and Villar, 2000] shows that the Central Bank has played a more important role than it should be filled with a conservative and politically neutral bureaucrats [Rogoff, 1985], as presented central bankers are portrayed in the literature about on Central Bank Independence (CBI) (see the discussion of Central Bank Independence in: Cukierman and Webb (1995), Caprio et al. (1996), or Aspiazu (2002).) The literature on Central Bank Independence concentrates on the influence of the governments on the behavior of central banks. There are however a few authors researching the question of the central bank's influence on the government, either through other instruments [Alt, 1991] or because the central bank has other objectives [Lohmann, 1992]. Despite this, the

political relevance of central banking or the interplay between a central bank and government are not new topics. The new approach of this work to the Central Bank literature is present in its analysis of their strategic behavior in light of political preferences.¹ What makes this research innovative then, is its analysis of the political motivation of the Central Bank to act strategically.

There is a tradition of strategic behavior among central bankers, but it does not include political preferences as for example the electoral output. For example, the party political hypothesis of Douglas Hibbs and Alberto Alesina argues that there are two constituencies (parties); one has a preference for low inflation, while the other party prefers the a higher rate of inflation. As a result, monetary growth, inflation, employment, and output “vary over time as a function of the party in power” [Sayer, 2001]. The Electoral Politics hypothesis of William Nordhaus asserts that governments (not central banks) have incentives to increase the money supply before elections to create employment and output, and “thereby increase their chances of re-election” [Nordhaus, 1975]. However, neither the former nor the latter approach addresses the research question herein presented. This leads to the argument made in this inquiry that the same bureaucratic central bank will decide at times in favour of a government and, under other circumstances, against them. In the same way, it should be clarified that when two central banks with differing ideological beliefs have passed the same decisions in the past, or when a central bank decides to overturn previous decisions. The other field of inquiry is about the sincerity or strategic character of the decision. Such a decision could be made due to the adoption of a defeating position over and against the government or because the central bank truly disagrees with the government, playing its natural bureaucratic role. The approach of the inter-temporal conflict of interest gives an answer to these questions derived from the main research question.

An agenda’s overturning is the reversal of decisions by the Central Bank, overruling its own action. This is reflected in research on similar institutions: for example, researchers have carried out projects with similar methodologies for Argentinean cases with comparable institutions, such as the Supreme Court (nominated by the executive, members confirmed by the senate, and have some degree of independence) [Helmke, 2002] and the Senate’s commissions [Llanos and Lemos, 2006] and have arrived at similar results. The political preferences of the Central Bank drive its behavior in the inter-temporal conflict of interest. The inter-temporal conflict of interest infers the closer the mandate’s end, the higher the likelihood of an agenda’s overturning. On the other hand, there is a control argument and it confirms that the closer the financial event, the higher the likelihood of legal change. This control argument captures the bureaucratic central banking forecasting of the crises.

¹The political preferences are those Alesina and Tabelini (2007) describe related to the electoral output.

The relevance of this survey for the field is revealed in its contribution to the three streams introduced in previous literature. The relevance of this new approach presents a new argument for the analysis of central banks and other similar institutions. For Central Bank Independence, the principal relevant improvement is the overcoming of the assumption that the central bank is just a technically bureaucratic institution; it postulates in fact that a central bank has important political interests. In the strategic literature, the relevance of the argument presented here is based first on the acceptance that a central bank has political preferences, and second, the acceptance of the agency of the central bank as a political decision-maker looking at the electoral effects of its actions.² or the government as actor making strategic decisions.³ The third relevant contribution is a systematic view of the historical literature about the decisions of the Argentinean Central Bank.

This research presents two new databases focusing on the behavior of the Argentinean Central Bank estimated through the regulatory system of the financial markets. The databases track 3,498 decisions and help explain the reversing of these decisions. The analysis further adapts a methodology of identifying and analyzing this behavior to determine the likelihood of carrying out a reversing (from supporting to defeating) legal change. It will explain the causes influencing the Argentinean Central Bank's behavior, identifying why the Central Bank acted the way it did during the different periods of government.

This research uses an Event History Analysis because of this method's ability to account for the problem of right censored data⁴ systematizing the time. Additionally, this model captures the likelihood of occurrence for a binomial variable (reversing of the agenda), depending on a group of explanatory variables. Returning to the research question posed, this research looks for systematic change in the likelihood of a reversal of policy, in relation to the period of different mandates (reelection and no reelection), which influence the interplay between government and the central bank. The results show the presence of supporting and defeating strategies.

This study is divided into five main parts: following this introduction, a review of the literature is presented, and the theory behind the study will be presented; then, the work will turn to explaining its analysis of the empirical work and, finally, the conclusion will sum up the findings and discuss the relevance of the results. The presentation of the theoretical background of this work will begin with a review of recent literature on these topics. In succession, the theoretical framework behind the model used in this analysis will be pre-

²The most important strategic developments in this respect have dealt with the acceptance of their technical preferences as determinants in central bank decisions. See e.g. the Political Party Hypothesis of Hibbs.

³See e.g. Political Business Cycle of Nordhaus (1975).

⁴The database of decisions is right censored by nature because of it does not include the non-failures, i.e., the decisions that were not overturned.

sented. Thereafter, a section on methodology details the definition of variables, research questions, hypotheses and the construction of the databases. The conclusion will then sum up the evidence found, indicating the political role of the Argentinean Central Bank, and providing open questions for further exploration in light of this new data and other potential data sources.

The literature section identifies the relevant gap between the streams of thought present in the literature. In essence, this section is included in order to provide a summary of the previous significant arguments presented in research of the field. Such previous findings are also relevant to this study, because in addition to forming the background for this work, the new argument presented here provides answers to a number of relevant research questions. The literature's three different streams of thought are detailed. The first approach (CBI and Reputation) captures the action of the government regarding the central bank and conceives of the central bank as a neutral political actor, the second approach focuses on one specific central bank in historical approach (Argentinean Confessions). Third, the last school of thought takes a central bank's systematic behavior into account, but ignores its political relationship with the electoral cycle. Thus, the inter-temporal conflict of interest presents a new perspective, joining the systematic behavior of central banks with a political explanation, in response to the literature on Central Bank Independence. This theory explains the argument of inter-temporal conflicts of interest step by step, intuitively and with a clear statement of the assumptions the theory makes. In following, the justification of the model includes a detailed definition of the preferences, priorities and beliefs which that form the background for this theoretical work. The discussion of equilibriums is an adaptation of a signaling game model [Helmke, 2005] for the Supreme Court of Justice. and the spatial model connects the game theoretical approach with the empirical observation.

The purpose of the analysis is to present empirical estimations of the overturning within the agenda made by the Argentinean Central Bank from 1991 to 2007. That part describes the construction of the variables explaining the reversing of the agenda, showing the different arguments. An important function of that part of this work is to justify the selected cases, the period of study, the researched object and the methodology used. For this research, those chapters include a detailed description of the data collection and coding of the variables, explaining the descriptive statistics of the variables used. Following that discussion, the section will describe the results and the evaluation of the main and control argument, as well as three robustness tests executed on the data, known as ageing, interactions and proportionality. In the end, the section connects the theory with the researched object, testing the hypotheses based on the theoretical assumptions and comparing it with the reviewed literature.

In conclusion, finally, the results will be reconsidered by analysing their relevance and discussing them within the perspective of the theory. The main argument keeps its weighted effect, showing the increment of strategic defeating through the reversing of decisions. In addition, the control for robustness (ageing and interactions) increases the significance of the main argument. The control argument shows that there is influence, however the influence does not show a strategic change between reelected and non-reelected governments, and displays a weaker stability than the main argument that there is an inter-temporal conflict of interest.

Chapter 1

From a Gap in the Literature to the Systematic Political behavior of the Argentinean Central Bank: The Literature on the Actors

The research on central banks faces the complexity of monetary institutions' behavior on the political and economic level. This state office regulates monetary policy, which can have huge distributive effects on wealth and electoral results [Lohmann, 1998, p. 402]. Additionally, the central bank is an important state office because of its likenesses with other relevant institutions (like the Supreme Court and some parliamentary commissions). As bureaucratic state institutions, such offices share numerous commonalities with respect to the nature of their conflicts with the executive, while maintaining their independence [Helmke, 2002, p. 294]. This research faces the definition of a modern Central Bank in developing countries or new industrializing countries (NICs) beginning with the difficulties to set boundaries for this institution.