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Kicking Away the Ladder, Too: Inside Central Banks

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Abstract:

Central banks are evolving institutions. In developed countries, particularly in Britain, central banks were used as instruments of the state to finance government and to promote economic development. However, once they went up the economic ladder, advanced economies kicked it to preclude developing countries from climbing it, too. It is in this context that the modern independent central bank, concerned with inflation targeting alone, which harkens back to the Victorian era, should be interpreted. This paper analyzes the recent evolution of the Argentine central bank in this broad historical perspective.

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Notes

[1] C.A.E. Goodhart (2011) suggests only three periods, disregarding the early period of central banking altogether. In part, his brief history of central banking is flawed, because that early history is fundamental to understanding what central banks can do in developing countries.

[2] On the concept of the developmental state, see Meredith Woo-Cumings (1999).

[3] This section is based on Matìas Vernengo (2015).

[4] The monopoly over the issue of banknotes came significantly later, only after Robert Peel's Bank Charter Act of 1844. For the early history of the Bank of England, see John Clapham (1944).

[5] This would be, for example, the argument in the now infamous paper by Carmen M. Reinhart and Kenneth S. Rogoff (2010), who claim that public debt above 90 percent of GDP has a negative impact on economic growth.

[6] Patrick O'Brien (2013) suggests that fiscal exceptionalism, related to the smaller and more urbanized polities of the west, explain why England and later western nations found it easier to tax their populations when compared to eastern empires with more extensive territories, larger populations, and less urbanized economies, even as the latter were in many respects more advanced than the former.

[7] Some authors would suggest that external demand was less relevant than domestic demand for the IR, but this is of secondary importance for the purposes of this paper. Specifically on the role of public money for the development of the financial sector and the IR, see L.S. Pressnell (1953).

[8] Domingo Cavallo, the Finance Minister behind the Convertibility Plan in Argentina, was explicit about his intention to emulate the currency board and the institutional arrangements of the Belle Epoque (see Pérez Caldentey and Vernengo 2007).

[9] In addition, the notion of demand-pull inflation in mainstream models hinges on the idea that the system tends to its natural rate of unemployment. The problems with this concept and its twin, the natural rate of interest – both logical, as highlighted in the capital debates, and empirical, as evidenced by its variability and path-dependency – suggest that the typical discussion of inflation in conventional models should be taken with a grain of salt.

[10] For a discussion of the external vulnerability of Argentina in the context of the dispute with the Vulture Funds, see Vernengo (2014).

[11] There is little evidence that the external accounts react to changes in the exchange rate in a very significant manner. Also, higher central bank rates could be more than compensated by lower rates provided by other public banks, as the Brazilian experience with the national development bank (BNDES) shows.

Additional information

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Matías Vernengo is a professor of economics at Bucknell University. He served as a senior research manager at the Central Bank of Argentina (BCRA, in Spanish) at the time that some of the reforms discussed in this paper were carried out. These are the author's personal views and do not reflect the opinions of any members of BCRA then or now.

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