Available online at www.sciencedirect.com

SCIENCE DIRECT®

Journal of International Money and Finance
22 (2003) 1065–1087

Journal of International Money and Finance

www.elsevier.com/locate/econbase

Currency boards, dollarized liabilities, and monetary policy credibility

Mark M. Spiegel *, Diego Valderrama

Federal Reserve Bank of San Francisco, 101 Market Street, San Francisco, CA, 94105, USA

Abstract

The recent collapse of the Argentine currency board raises new questions about the desirability of formal fixed exchange rate regimes. This paper examines the relative performance of a currency board with costly abandonment in the presence of dollarized liabilities to a fully-discretionary regime. Our results demonstrate that neither regime necessarily dominates with only idiosyncratic firm shocks, but discretion unambiguously dominates with the addition of shocks to the dollar-euro rate. The relatively strong performance of the discretionary regime in this model stems from the benign impact of dollarized liabilities on the monetary authority's time-inconsistency problem.
© 2003 Elsevier Ltd. All rights reserved.

JEL classification: F31; F32; F34

Keywords: Currency board; Default; Dollarized liabilities

1. Introduction

The recent collapse of the Argentine currency board has resulted in renewed attention on this form of exchange rate regime. Prior to this event, many had argued that "intermediate" exchange rate regimes had fallen out of favor (e.g. Frankel et al., 2001), with pure floats or hard pegs, such as formal currency board arrangements, dominating them in terms of economic performance. The dramatic collapse of the Argentine economy raises new questions about the desirability of currency boards in modern developing economies.

* Corresponding author. Tel.: +1 415 974 3241; fax: +1 415 974 2168.
E-mail address: mark.spiegel@sf.frb.org (M.M. Spiegel).

0261-5606/$ - see front matter © 2003 Elsevier Ltd. All rights reserved.
doi:10.1016/j.jimonfin.2003.09.010

The historical evidence on the empirical performance of currency boards suggest that they do have a disciplinary effect on policy and have tended to be successful. Ghosh et al. (2000) report that exits from currency boards have been very rare.[1] Moreover, currency board countries exhibit lower inflation, lower fiscal deficits, and lower average rates of monetary growth.

While exits from currency boards are rare, pegged exchange rate regime collapses are not. The prevalent pattern observed in the literature is that when fixed exchange rate regimes do collapse, their collapses tend to be "…messy and costly" (Edwards, 2002). For example, Edwards and Edwards (1987) report that Chilean GNP fell by 19 percent in 1982 subsequent to its devaluation, after accounting for terms of trade changes. Downturns of this magnitude are not uncommon following exchange rate collapses.

Given the experience with pegged regime collapses, it appears likely that when currency board collapses do occur, they would be even more disruptive. The historical record of currency board safety is likely to induce agents to feel free to denominate contracts in local and hard currencies interchangeably, leaving widespread potential for currency mismatches in the wake of a currency board collapse. That of course has been the experience with Argentina. From 1999 through 2002, GDP per capita in Argentina fell by over 50 percent while unemployment rose to 23 percent.

One notable feature of Argentina's collapse is the contribution of weakness in its financial sector. De la Torre et al. (2003) note that while Argentina's currency board led to increased financial deepening in that country, it did so at the expense of greater financial fragility. Because a currency board left open the opportunity to devalue at some cost, it left Argentina exposed to expectations of devaluations and "sudden stops" in capital inflows. These sudden stops led to widespread disintermediation and financial turmoil.

Subsequent to devaluation, problems were particularly acute among agents facing dollar-denominated liabilities. A number of recent papers (e.g. Calvo and Reinhart, 2002; Aghion et al., 2001) have argued that using an exchange rate devaluation to respond to an adverse shock can be counterproductive in the presence of dollarized liabilities. While devaluations can have a positive impact on export performance, they may also have an adverse impact on domestic balance sheet positions. These adverse balance sheet effects may then exacerbate economic downturns if production is dependent on external funds, as in Edwards and Vegh (1997).

There is ample empirical evidence that the dollarization of liabilities in the financial sector has exacerbated the adverse effect of devaluations. For example, Edwards and Edwards (1987) argue that Chile's financial liberalization prior to the 1982 crisis encouraged its financial conglomerates to increase their dependence on

[1] Ghosh et al. (2000) report a number of incidents where countries moved from currency boards to hard pegs at prevailing rates subsequent to independence, but such regime changes appear to have modest immediate real economic impacts.

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات