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What if Alexander Hamilton had been Argentinean? A comparison of the early monetary experiences of Argentina and the United States[☆]

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Abstract

The contrast between the early nineteenth century Argentinean experience of high inflation and the American experience of low inflation is interpreted in terms of an optimal taxation model. It is argued that the two countries' experiences diverged because of the different constraints they faced in financing wartime government expenditures. In the presence of frequent wars, ever-tightening access to foreign capital, and an inadequate tax base, Argentina's use of the inflation tax may be viewed as an optimal solution to its wartime problems. By contrast, with the exception of the Revolutionary War, the absence of such constraints in the United States required full-tax smoothing, with only a temporary use of the inflation tax during wartime. Such policies were embodied in Alexander Hamilton's fiscal package of 1790, which allowed the United States to bond-finance most subsequent wartime expenditures. © 2002 Published by Elsevier Science B.V.

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1. Introduction

No hay más que una esperanza de que el papel-moneda de Estado, una vez establecido y convertido en hábito, desaparezca, y es la de que arruine y entierre al gobierno que lo ha creado, por su propia virtud de empobrecimiento y de ruina. Entonces se verá producirse este fenómeno, que no es sino muy concebible y natural: que el gobierno que necesitó crear el papel moneda para existir, tendrá que suprimirlo para conservar su existencia.¹

Juan Bautista Alberdi (1810–1884)²

As the prophetic introductory quote suggests, Alberdi saw it as a distinct possibility that a government would have to eliminate *de facto* the national currency to preserve its own existence. In this light, the highly successful 1991 Argentinean Convertibility Plan, which basically established a currency board, is perhaps the ultimate tribute to Alberdi's deep-rooted distrust of inconvertible paper-money: after hyperinflation threatened to destroy the social fabric of the country, the Argentinean government had little choice but to destroy the monster—for inconvertible paper-money was no less than that in Alberdi's mind—that it had created roughly 170 years before.

Up until the 1991 Convertibility plan, Argentina provided a consummate example of a chronic inflation country. In the 20th century, it experienced chronic inflation since the early 1950s in spite of repeated stabilization attempts. Argentina's stormy relationship with inflation, however, goes back to the early 19th century, as Alberdi's virulent attacks on paper-money and ensuing inflation vividly illustrate. Indeed, the first long period of high inflation (in what would later officially become Argentina) goes from the mid-1820s—roughly a decade and half after the 1810 Revolution from Spain—to the early 1860s. Even in the following 80 years, when inflation on average was not exceptionally high, there were a number of inflationary episodes and successful adherence to convertibility rules was rare. Thus, taking a long sweep of history from 1810 to 1990 suggests that the experience of the first half of the 20th century—when the average inflation rate was relatively low—is an aberration from a more permanent pattern of high and chronic inflation, which may have been finally broken by the quasi-currency board established by the Convertibility Plan.

Argentina's long inflationary history stands in sharp contrast to the tradition of price stability of a country such as the United States which, in spite of initiating its independent life under broadly similar circumstances, followed quite a different path in this respect. In effect, although the United States had episodes of

¹“There is only one way in which the State-issued paper-money—once it has been established and become a habit—will disappear, and that is that it ruins and buries the State that created it, by virtue of its own capacity for impoverishing and ruining. Then the following phenomenon will take place, which is only very conceivable and natural: the government that needed to create the paper-money to exist will have to suppress it to preserve its own existence.” (Authors' translation.)

²Alberdi was one of the most influential political and economic thinkers of 19th century Argentina. The above quote, reproduced in Alberdi (1989, p. 162), belongs to a manuscript on an economic interpretation of Argentina's political history published after his death.

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