Commitment Devices with Time Inconsistency Disease and Institutional Anomie
The Case of Argentina

Emilio Ocampo
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The World Champions of Stagflation 1999-2023

Number of years with an annual inflation rate in the world’s top decile

Number of years of negative GDP per capita growth

Source: Author based on latest IMF WEO and World Bank WDI data.
Time Inconsistency Disease

“Argentina is my prime example of a country that suffers from what I call the time inconsistency disease.

Policy seems to be very short run-oriented, which is bad for long run sustainable growth.

You see it in monetary policy but also in fiscal policy.”

Finn Kydland (2004)
Is Time Inconsistency Disease Curable?

“An interesting question is: if a nation, such as Argentina, falls prey to the time inconsistency disease, how easy is it to rebuild its credibility?

The answer has to be, not easy at all.”

Finn Kydland (2004)
Difficult when Institutional Anomie Prevails

• The term originated in Nino (1992) and Waldmann (2004)
• Weak separation of powers → Executive Overreach
  • Laws are ignored, abrogated or modified by the Executive
  • Executive does not enforce the laws, it is the main law-breaker
• Congress and Judiciary passive enablers
• No formal ECD can exist under local jurisdiction
• Acute institutional anomie tends to be associated with endemic populism
Two Sides of the Same Coin

- Time Inconsistency
- Disease
- Acute Institutional Anomie
Populism and Institutional Anomie: A Vicious Cycle

- **Populism**
- **Voter develop hyperbolic discounting**
- **Institutional Anomie**
  - High inflation
  - Macro Instability
  - Uncertainty
  - Stagnation
- **Policy Time Inconsistency**
  - Fiscal deficits
  - and soft money
# CDs as a cure for Time Inconsistency

## A Menu of Commitment Devices (CDs)

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Menu of Commitment Devices

**Formal**
- Central Bank Independence
- Fiscal Rules
- Currency Board

**Internal**
- Rendered ineffective by institutional anomie

**External**
- Bond Covenants
- IMF Conditionality
- External Supervision (Austria, 22)
- International Currency Agreements (BW)

**Informal**
- Voter intolerance to inflation
- Banking Lobby
- Markets already closed

**Dollarization**
- Gold Standard

**Voters are time inconsistent and exhibit hyperbolic discounting**

**Banks profit from inflation, earn seignorage**

**Politically unpopular**

**Practically unviable**

**Reputation already damaged**

**Markets already closed**

**Rendered ineffective by institutional anomie**
Evidence of Institutional Anomie: 
\textit{de facto} CBI < \textit{de jure} CBI

Indices of \textit{de jure} Central Bank Independence (1960-2023)

Source: Romelli (2022, 2024)
Credible vs. Non-Credible Commitments: The Case of Argentina

1967    Public announcement by Economy Minister (3 years)

1978    Public announcement by Economy Minister (3 years)

1985    Austral Plan by Presidential decree (10 months)

1991    Convertibility Plan by Law approved by Congress (10 years)

2015    Presidential “promise” of Central Bank Independence (2 years)

2023    Presidential “promise” of 2% crawling peg (4 months so far)
No Credibility with Institutional Anomie

Credibility of Policy Regime

Argentina 2024

Expected Probability of Reversal

C* PR* PR^ 100%
Credibility with Institutional Anomie

Credibility of Policy Regime

C^*

CR^A

CR^*

Argentina 2024

Expected Probability of Reversal

Cost of Reversal

29-Apr-24
Credibility with Institutional Anomie

Dollarization has the highest cost of reversal

29-Apr-24
Effective Commitment Devices (ECDs)

“The commitment level to a policy regime is determined by the political cost of breaking it.”

Alan Cukierman (1993)
Dollarization as an ECD

“There are few politicians in Ecuador who currently talk about a possible return to the sucre. The debate on de-dollarization is almost non-existent.

And the sucre represents the past for many. It is the memory of the economic crisis and the constant devaluation that ruined the economy for millions of people.

The dollar, on the other hand, represents stability. It is viewed as a strong currency managed from abroad. And in this, some economists say, lies the key to its success among Ecuadorians.

According to the last survey carried out in the country on the subject, which dates back to 2015, 85% of Ecuadorians responded that they support dollarization.”

BBC News, January 2020
Dollarization can break the Vicious Cycle of Populism

- Voter hyperbolic discounting
- Policy Time Inconsistency
- High inflation
- Macro instability
- Uncertainty
Milton Friedman was Right

“The whole reason why it is an advantage for a developing country to tie [its currency] to a major country is that, historically speaking, the internal policies of developing countries have been very bad. U.S. policy has been bad, but their policies have been far worse. There are no gyrations in American monetary policy which can hold a candle to the gyrations which have occurred in Argentinian domestic monetary policy.

So, the whole reason why tying to a major currency would be an advantage to Argentina is that precisely that it would prevent them from following bad domestic monetary policies. They would have less of an adjustment problem simply because our policy will prove to be more stable than theirs.”

Milton Friedman, Testimony to Congress, June 1973
Thank you