



“Crisis, adjustment and poverty” The end of Austerity?

ECON 5450 Crises Adjustment & Poverty
Fall 2018 Intro lecture notes
Darryl McLeod, Fordham University

Key ideas this lecture

- Austerity/Stabilization, end of?
- Heterodox policies
- Graduation/Orthodox policies
- The Belassa-Samuelson effect

Key people countries

- Chile's Mapuche People
- Marci/Abe/Argentina/Japan
- Ghana's President and JFK
- Plurinational Rep of Bolivia
- Cristine Lagarde.. Peru

Key economists

- Amartya Sen
- J. Sachs and F. Larraine
- Ghana's President and JFK
- Vietnam/China... cashews..
- Cristine Lagarde.. Peru

Unlikely hero, we hope....

USD to MXN Chart

Send Money Now

18 Jan 2016 00:00 UTC - 17 Jan 2018 14:37 UTC **USD/MXN** close: **18.75054** low: **17.15586**
high: **21.95646**



Crises, Adjustment and Poverty 2018:

Crises

- Crises: almost all countries growing, few threats to global growth the horizon (China? Bubbles?)
- Acute crises outside the UN-IMF's jurisdiction: Puerto Rico's chronic debt crisis and acute climate shock (Maria) and Venezuela's ongoing famine...
- Chronic Crises: mitigating climate shocks: resilience and UN DESA WESS Report on resilience
- Changing perspectives on Greece and the EU...



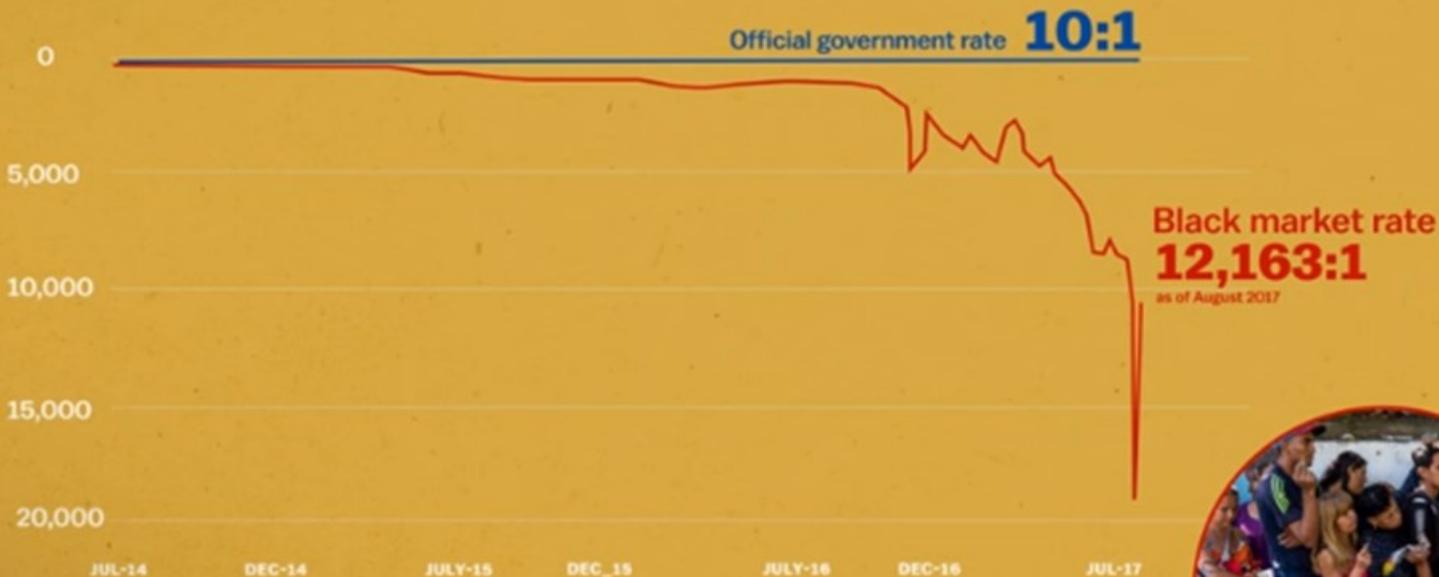
My research at the UN and WB

[Short video summary](#)

Worst Crisis of 2018: two famines Sudan vs. Venezuela

Venezuelan currency rates

Banco Central de Venezuela, CATO Institute



- [Source: Vox Venezuela video minute 5](#)

Interesting sidelights.... 2018

- How had Cristine La Garde change the IMF? Bretton Woods, Why IMF always led by Europeans, head of World Bank always American? [Harry Dexter White vs. JM Keynes](#)
- What happens when crises are outside the reach of the IMF? Debt crises in Greece and Puerto Rico
- Have Argentina and Japan turned the corner? Macri takes on new pension reform... 20% inflation persists...
- Puerto Rico a state or a LatAm country (compared to other Latin American Jurisdictions)?

UNICEF, 1987
Adjustment
with a human
face....



Old Key words, events, people.... 2015

- Mario Draghi (aka super Mario, “the dragon”) say to end the 2010 Euro crisis...
- Why did Christine Lagarde “red card” Cristina Fernández de Kirchner,
- Why Ali Zafar say a sailing ship as he drove into in Accra, Ghana from land locked Burkina Faso?
- Simon Kuznets said there are three kinds of countries, what are they?
- Original sin, redemption, graduation (Ricardo Hausmann, [Carlos Vegh](#), How do countries graduate? (R&R this time is different)

The benefits of currency unions: what went wrong in the Greek-EU-GIPSI countries? Is it fixed?

- Overlooked banking crises, especially those triggered by Sudden stops
- Focused on long run goals, not crises: labor mobility and better institutions.
- Fiscal and Monetary union cannot be separated look at Nevada vs. Detroit vs. Puerto Rico for example
- Better than Autarchy North Korea, Myanmar, Cuba, Zimbabwe

New Vox-eu-book Eurozone Crisis autopsy says private capital flows + sudden stop

- R. Dornbush and A. Werner presented a paper saying the Mexican crisis of 1994 was inevitable due to currency overvaluation, a banker in the audience observed “it is not the speed that kills, it is the sudden stop...” Guillermo Calvo Carlos Vegh et al.
- Lack of instruments (currency or money makes crisis much worse)
- Are private capital flows and CA imbalances intrinsically bad? No... Myanmar, Cuba North Korea complete autarchy is bad.

From 1979 to 2008 crises mainly in emerging markets, massive surges of Aid post cold war

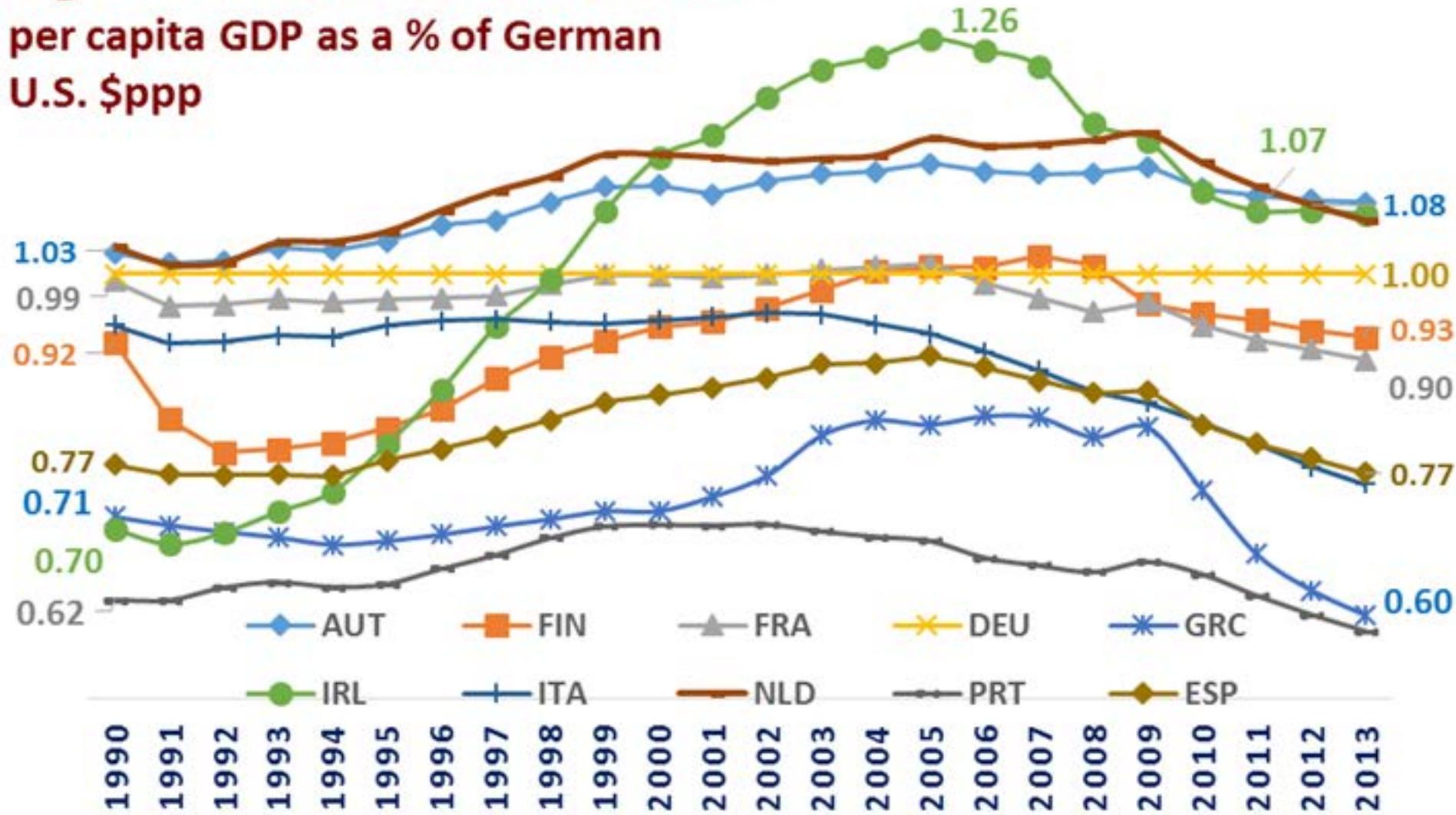
As Krugman said about low wage exports, *“In short, my correspondents... have not thought the matter through. And when the hopes of hundreds of millions are at stake, thinking things through is not just good intellectual practice. It is a moral duty.”*

(Paul Krugman, 1997 [*In praise of cheap labor*](#), Slate Magazine)

Similarly, the incomes and employment prospects of millions hang on recent debates over using internal devaluation to keep the Euro (Spain, Greece & Portugal), over the efficacy of austerity (how large is the fiscal multiplier in the Financial Times, and on Steven Colbert... over the Reinhart and Rogoff 90% debt to GDP tipping point.

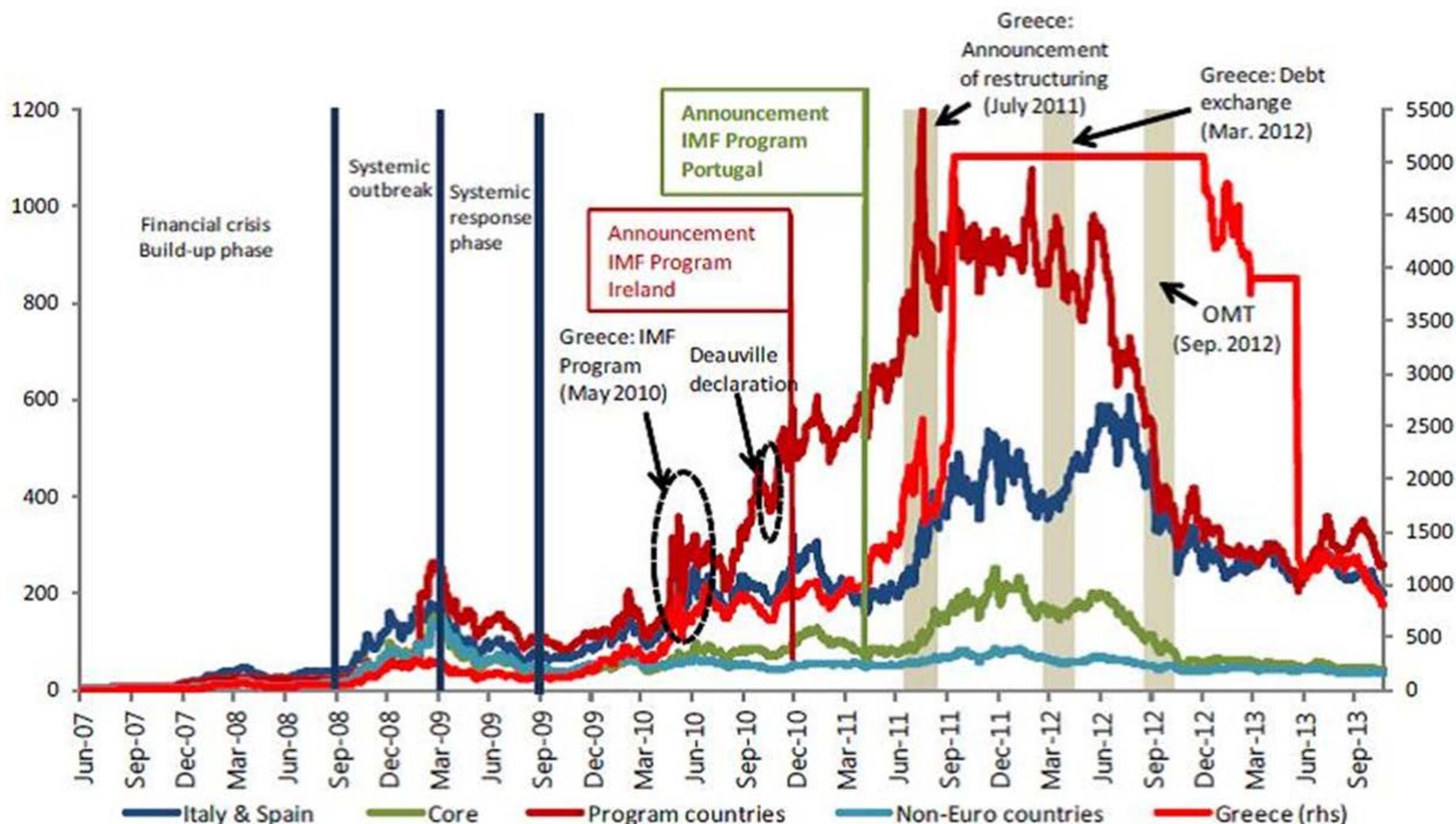
Figure 8: Has the EU worked?

per capita GDP as a % of German
U.S. \$ppp



SOURCE: IMF, WORLD ECONOMICS OUTLOOK DATA BASE, APRIL 2013.

Figure A. CDS spreads in selected countries during the European crisis, 2007-13



Source: Bloomberg, Datastream and IMF staff calculations.

Note: Core countries: Germany, France, Austria, Netherlands and Belgium. Program countries: Ireland and Portugal. Non-Euro countries: US, UK, Japan, Switzerland and Sweden.

Understanding the EU & Greece: inflation vanished...

- The promise of the Euro and dollarization (Ecuador, Panama, Puerto Rico) was low inflation and low interest rates (and capital inflows)
- It worked, but became perverse when inflation vanished and the threat was deflation... aka “depression economics” ; secular stagnation, liquidity trap (zero interest rates)
- Inflation and devaluation create real wage flexibility where there was none...

Understanding the Greece and Argentina: CONTAGION...

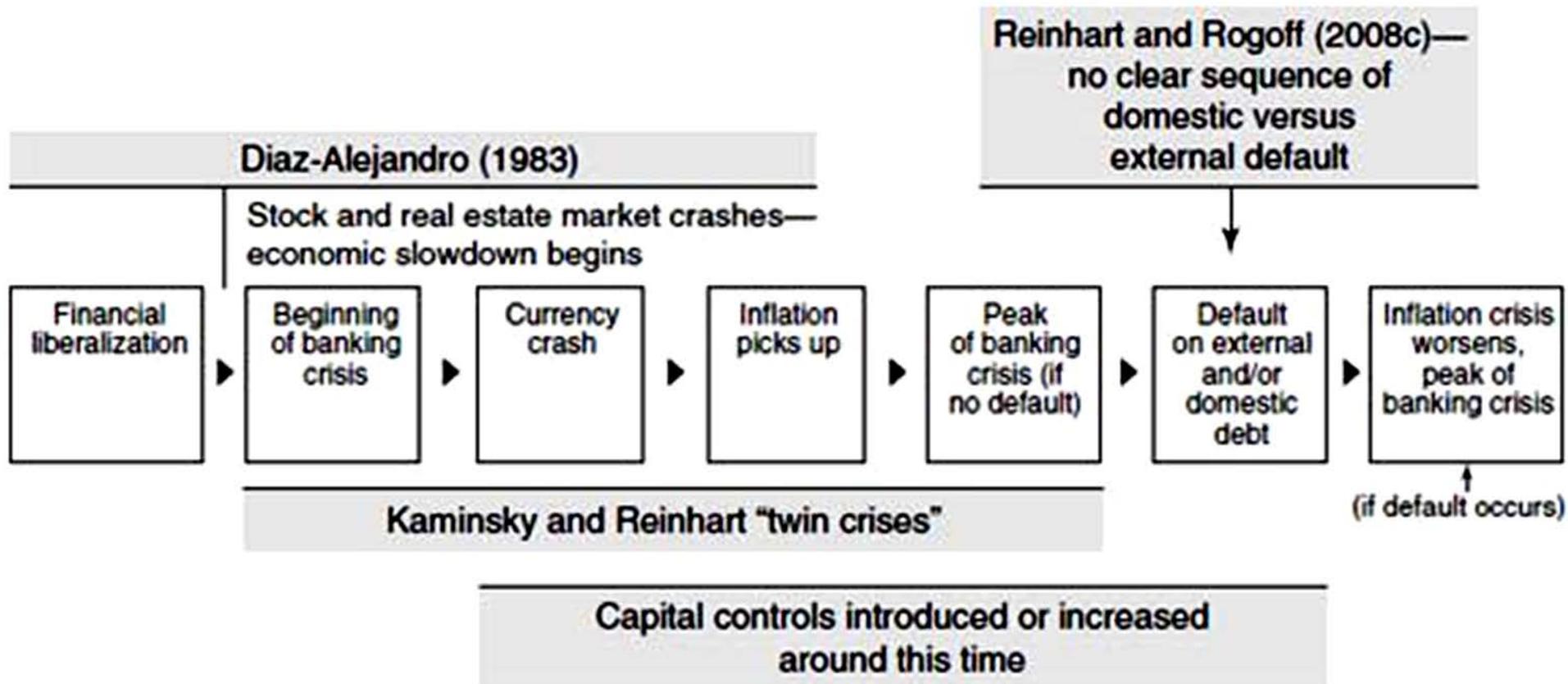
- The IMF was conceived to manage external imbalances w/o competitive devaluations of 1930s
- Devaluation is a “beggar thy neighbor” policy to minimized or combined with “good neighbor” policies... “Three Arrows of Abe Economics” or Germany’s Hartz reforms...
- Timing matters: kicking the can down the road can reduce contagion (preview crisis, then delay...)

Inflation can be too low: deflation is worse than inflation...downward spiral

- Answer is massive expansion of money supply and increase in public debt to finance infrastructure.
- U.S. economy reflatated by Quantitative easing
- The U.S. had a real estate boom financed by China 2000-2007 after internet bubble ended.. .
- China had a real estate boom after 2008, now over built growth is slowing...

Figure 16.12. The sequencing of crises: A prototype.

Sources: Based on empirical evidence from Diaz-Alejandro (1985), Kindleberger (1989), Demirgüç-Kunt and Detragiache (1998), Kaminsky and Reinhart (1999), Reinhart (2002), and Reinhart and Rogoff (2004, 2008c), among others. Reinhart, Carmen M.; Rogoff, Kenneth (2009-09-11). *This Time Is Different: Eight Centuries of Financial Folly* (Chapter 16 Kindle Locations 4401-4403). Princeton University Press. Kindle Edition.



Is this time different?

(page 123, R&R occupy handbook essay, 2012)

Table 1. Quantitative Antecedents of Financial Crises: The "Lead" of the Leading Indicators

Large capital inflows

Sharp run-ups in equity prices

Sharp run-ups in housing prices

Inverted V-shaped growth trajectory

Marked rise in indebtedness

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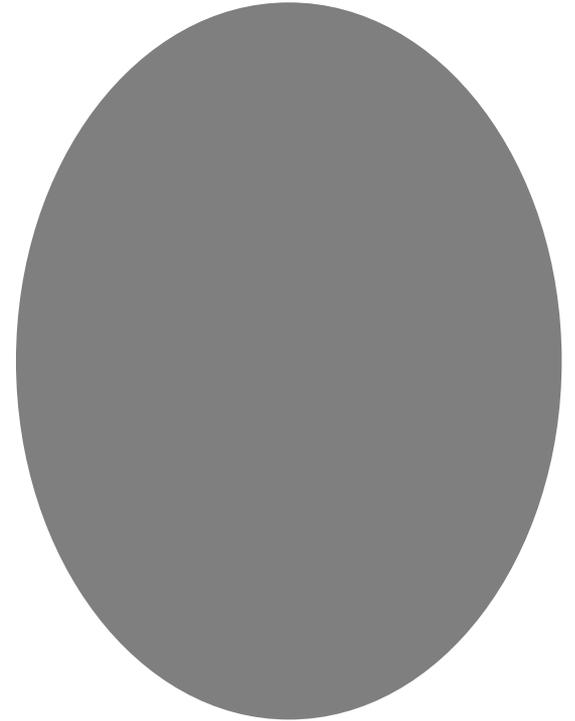
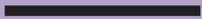
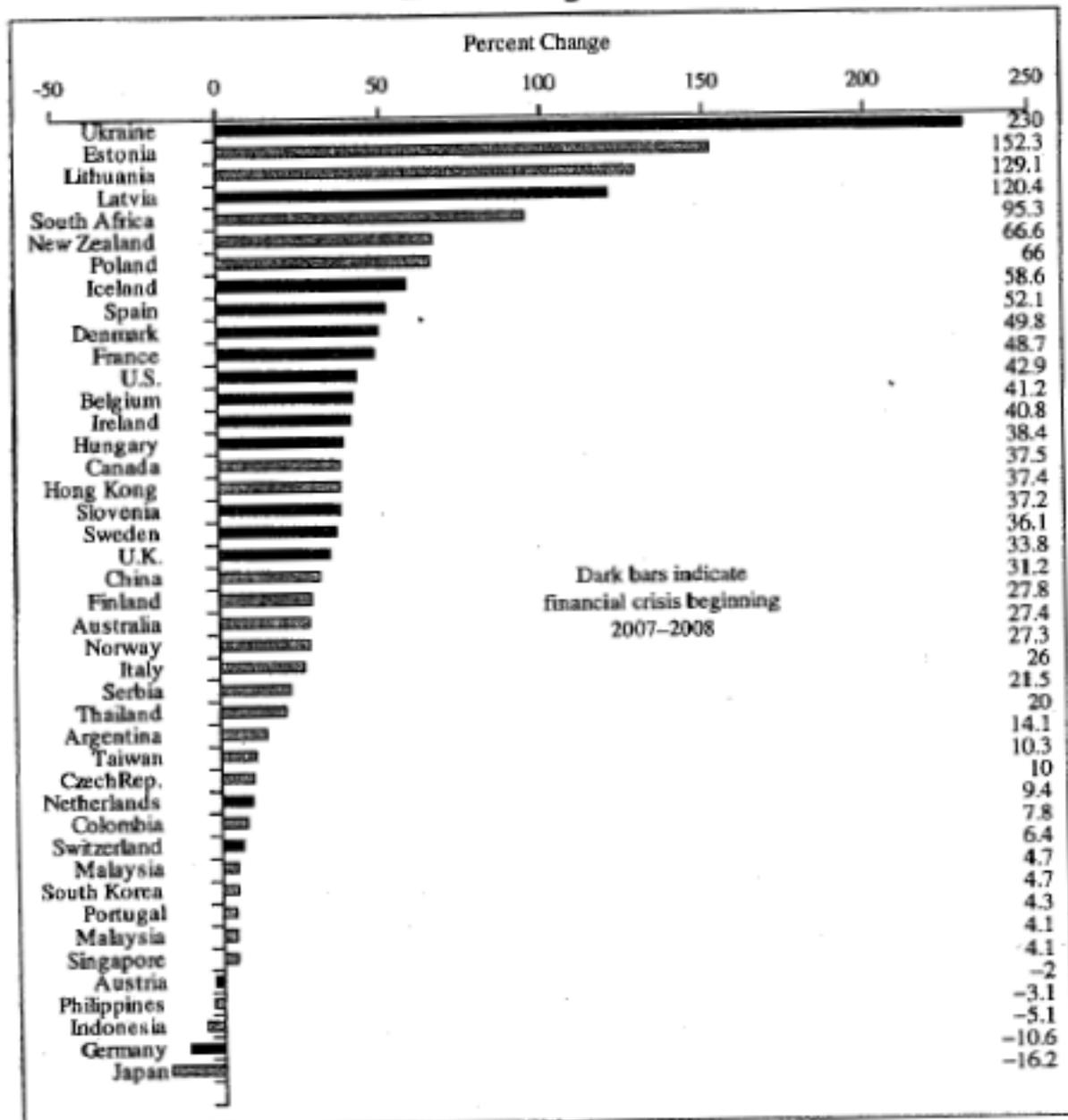


Figure 2. Percent Change in Real Housing Prices (2002–2006) and Banking Crisis



Is this time different?

(page 126, R&R occupy handbook essay, 2012)

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Table 3. Amplifiers of Boom-Bust Cycles: The Usual Suspects

Procyclical macroeconomic policies

Hidden debts (implicit guarantees)

Overvalued currencies

Poor regulation

Even worse supervision

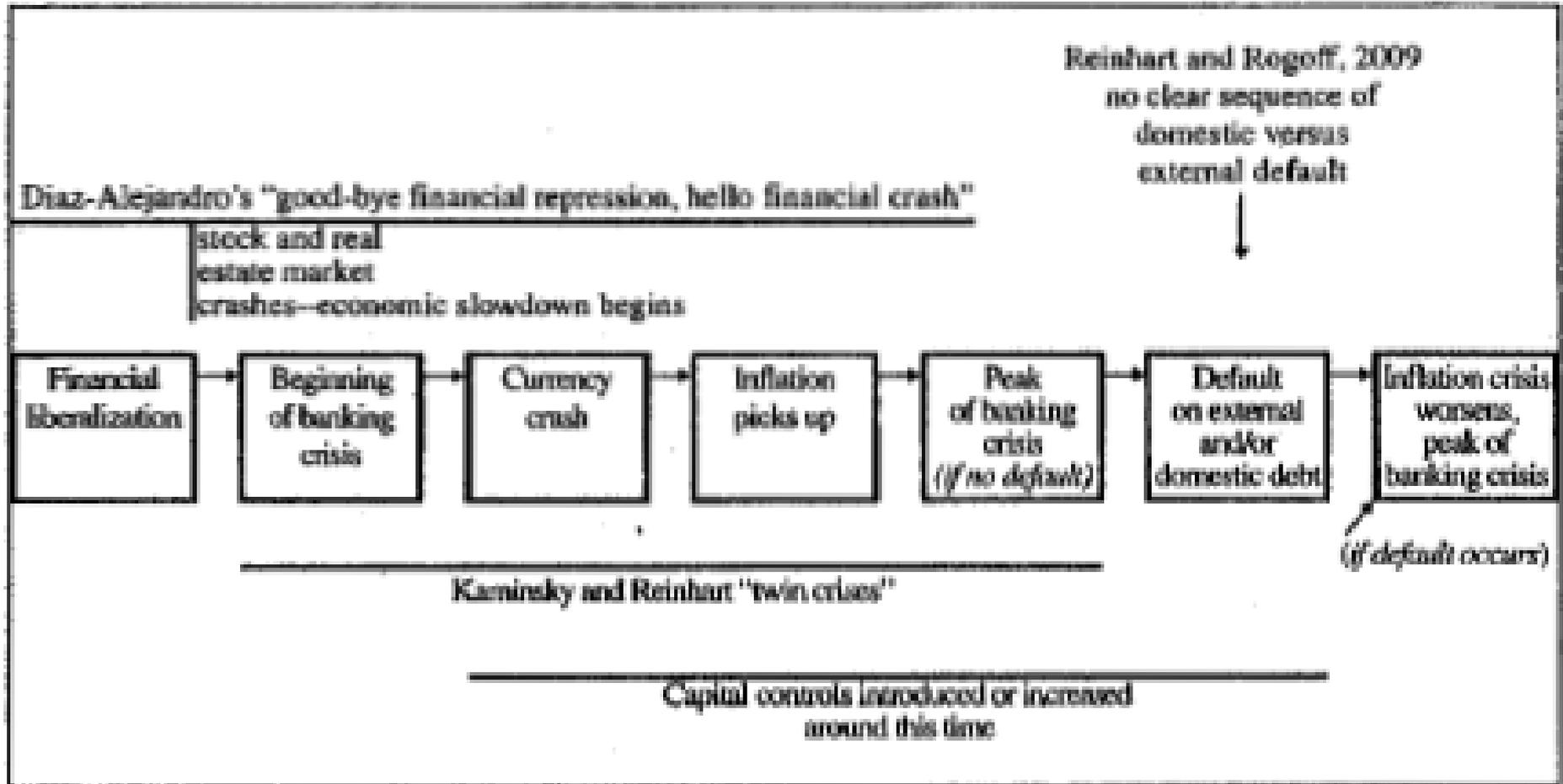
Outright fraud

Myopic credit rating agencies

Is this time different?

(page 130, R&R occupy handbook essay, 2012)

Figure 3. The Sequencing of Crises: A Prototype



Source: Reinhart and Rogoff (2009) and sources cited therein.

Key questions

- **Can financial crises be prevented?** Answer no: but trying creates lots of jobs
- **Should we prevent financial crises (bubbles, Minsky moments)?** No probably not... see this time is different or Manias crashes & panics
- **Can we minimize the duration and speed recovery from financial crises?** Yes, and we can and have: this is the scandal of Greece.
- **Can we mitigate the impact of crises on the poorest?** *Yes absolutely UNICEF “adjustment with a human face”*

Successful adjustment means keeping kids in school: CCTs school lunches Indonesia and Brazil and Chile...



Managing aid surges in Aid inflows: HIV, Ebola, remittances

Macroeconomic Challenges of
Scaling Up Aid to Africa
A Checklist for Practitioners



In the news: Fed Tightening

- September Fed tightening? how negative for emerging markets?

Book review?

Global

Finance

Grudge

match:

Keynes v.

White

Ben Steil

Net international Investment Position as a % of GDP

Emerging market macroeconomics....

- Key question: can one print one's own currency, or not?
- The IMF & Contagion... beggar thy neighbor
- Quantitative easing heads to EU (QE 1 to 3)
- Generations of currency crises:
 - 1st Fundamentals, deficits matter (Krugman, 1979)
 - 2nd Self-fulfilling crises: Europe 1993
 - 3rd triggered by financial liberalization

- http://www.gdsnet.org/ECON3235Fall2017_AlternativeHighInflationStbzPrograms.pdf
- VOX [Venezuela](#)
- [Commanding Heights](#)
- <Http://digamo.free.fr/krugman12.pdf>
- [Graduation](#)
- [The Peso](#)

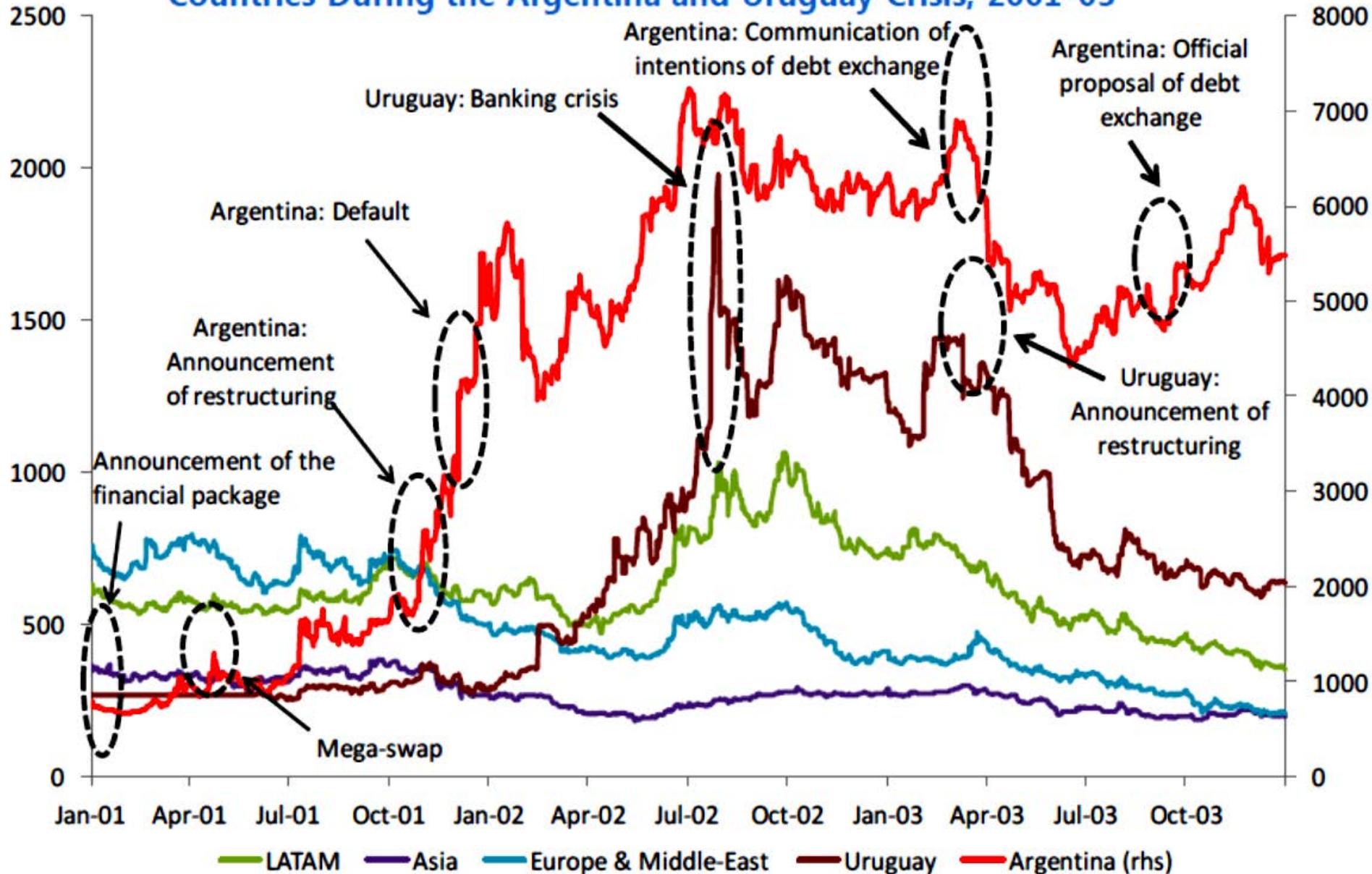
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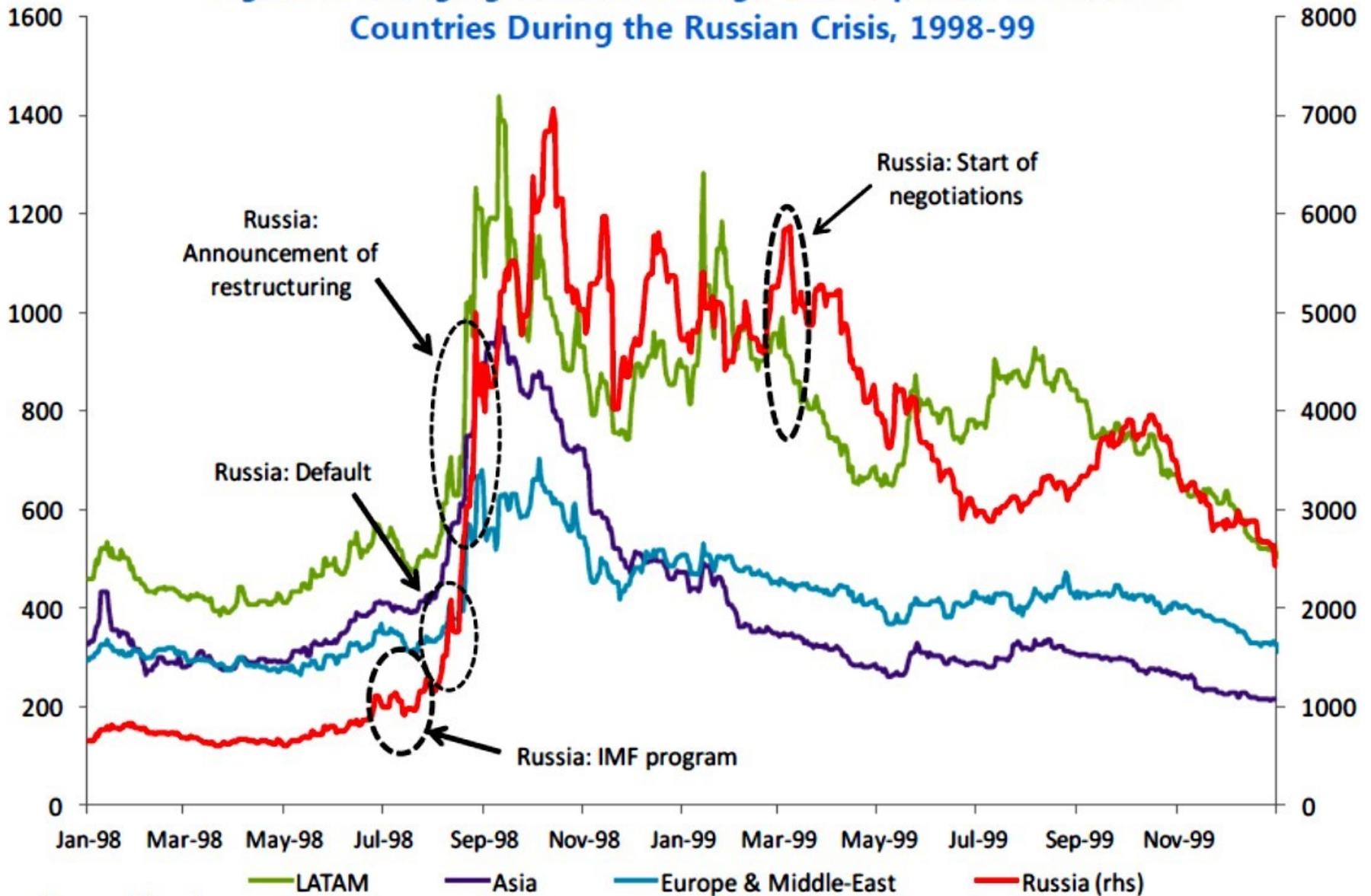
Note: Core countries: Germany, France, Austria, Netherlands and Belgium. Program countries: Ireland and Portugal. Non-Euro countries: US, UK, Japan, Switzerland and Sweden.

Figure B. Emerging Market Sovereign Bond Spreads in Selected Countries During the Argentina and Uruguay Crisis, 2001-03



Source: Bloomberg.

Figure C. Emerging Market Sovereign Bond Spreads in Selected Countries During the Russian Crisis, 1998-99

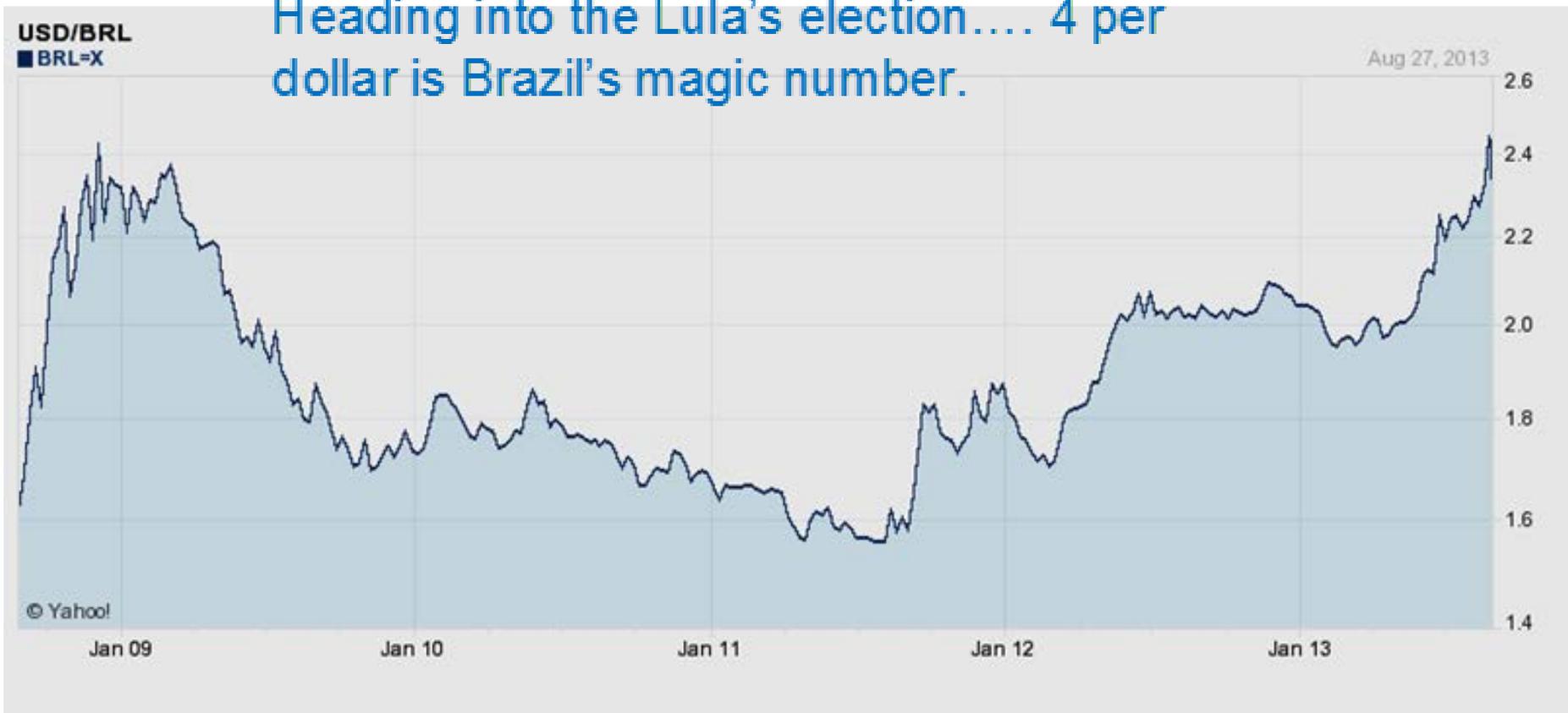


Source: Bloomberg.

Note: Latam: Argentina, Brazil and Mexico. Asia: Malaysia, Philippines and Thailand. Europe & Middle-East: Poland and Turkey.

Storm clouds on the horizon: Rupee and Real under pressure

e = 2.33 Brazilian Reals per \$U.S. about the same as October 2008, but not as weak as Heading into the Lula's election.... 4 per dollar is Brazil's magic number.



Storm clouds for the 4 Rs: Rand, Rupee, Rupiah & Real under pressure

e = 69 Indian rupees per U.S. dollar (\$US) up from 45 per \$US in early 2011, the rupee is depreciating against the dollar because the dollar costs (earns) more rupees now than it did a year or two ago... 70 vs. 40 is a big depreciation, though real terms it is not as large as it looks... why? (8-27-13 source: yahoo finance)

INR=X
■ INR=X



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Motivation: can emerging markets help us understand causes of 2008-11 crisis?

1. **Yes, Current account Imbalances**– Reinhart & Rodrik, 2010, Geithner's savings glut, and Krugman too in end this depression now.... The Chimerica problem, U.S. and China... see the Metzler diagram
2. **yes, Monetary policy** too loose (John Taylor)
3. **Lax regulation No**([excessive leverage](#), John Geanakoplos [itunes](#) & [Hyun Song Shin's](#) comment on JG's leverage & the [Squam lake report](#))
4. Yes, Triggered by a **white Swan event** ([Kurgans & Wells, Roubini](#)) **Why are real estate bubbles so common?** (Thailand, Spain, Ireland, U.S. [Poland](#) largest of all?--)
5. **Policy mistakes but also quick adjustment response-** some blunders, see [Blinder NYT](#), Federal reserve and Chinese central bank avoided another [another great depression](#) by printing money... was this the adjustment policy? (hint depression economics)

Answer: yes #1,2,4 and 5 (a little bit, indirectly)

CAP-1: “real” side: CA imbalances

CAP-2: Banks & currencies Part 2 Issues

- ❑ Economic populism: fiscal deficits lead to currency crises (Krugman speculative attack model)
- ❑ Currency mismatch aggravates banking crises, contagion (balance sheet effects).
- ❑ **Moral Hazard: why Lehman had to fail:** Mistakes by IMF/central banks in crisis response (Asia-contagion, Debt crisis 1980s, Lehman collapse)
- ❑ Policy errors in crisis response, delayed stabilization, capital controls

Adjustment models earlier LDC crises- lessons learned...?

- ❑ **Volatile capital flows (India, Brazil) Private capital flows:** sudden stops or Current Account reversals (see R&R and Calvo & Reinhart)
- ❑ **Fixed exchange rates hazards:** inability to save banks, or default on external debt, painful “internal devaluation”
- ❑ **Vulnerability high public/external debt ratios limits options:** debt relief may be necessary for recovery Greece, Mexico

CDS spreads

- CDS spreads (a measure of risk... **Example:** If a CDS has a spread of 976 basis points for a five-year Dubai debt it means that default protection for a notional amount of \$1 million costs \$97,600 per year (or \$24,400 per quarter).
- <http://www.fordham.edu/economics/mcleod/>
- <http://www.gdsnet.org/NotesonAdjustmentinDevelopingCountries.pdf>