Fixed exchange rates
The lessons from Argentina

Edwin Truman, senior fellow at the Institute for International Economics, argues that rigid fixed-exchange-rate systems, like that adopted by Argentina, do more harm than good.

Argentina is an economic, financial, political and social tragedy, a tragedy that should not be repeated. Argentina’s experience over the past decade points to multiple lessons, especially about fixed-exchange-rate regimes. Does Argentina’s experience reinforce the view that fixed-exchange-rate regimes are brittle? Does a hardened peg alleviate that brittleness? Is a pure floating regime the only realistic alternative? Is there a better way? Yes, no, no, and yes.

In 1991, to deal with hyperinflation, the Argentine authorities opted for a particularly rigid type of exchange-rate-based stabilization regime, one carved into law guaranteeing the convertibility of one peso into one dollar and supposedly backed by a currency-board type of monetary policy framework. Eleven years later, Argentina defaulted on its sovereign debt, its exchange-rate regime collapsed, its banking system imploded, and the economic and financial costs are mounting.

Was the experiment worth it? Only the citizens of Argentina can answer that question. Convertibility was associated initially with four years of spectacular growth, but the economy contracted by more than 8% over the past three years. Nevertheless, real GDP increased on average 3.4% a year over the 11 years to 2003, compared with a contraction of about 1% a year during the previous 11 years. In the not-unlikely event of a further 10% contraction in 2002, annual growth since 1990 would still have averaged 2.3%.

In the end, the failure of the Argentine economy to grow undermined political support for the policies necessary to sustain Argentina’s exchange-rate regime and led to devaluation and default.

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