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Memo: What Would It Take for the United States to Become Another Argentina?

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Today's Argentina is the result of an economic process that covered many years. Argentina was a prosperous, modern and successful economy in 1918. Even as late as the end of World War II it was a .rich economy. It did not turn into today's poor, backward and failed economy overnight. There are many historical, institutional and industrial and labor policy reason's for the transformation from advanced to backward status. As the precise microeconomic conditions that ruled in Argentina over the past forty years are not likely to be replicated in the United States or in any other of today's rich countries, we can just note that there were a number of product andlabor market conditions in Argentina that fostered inefficiency and turn to the macroeconomic conditions. This focus is valid for other countries can readily replicate the fiscal and monetary policiies that are the macroeconomic relations that are largely responsible for the the condition of Argentina.

The dismal condition of Argentina today is not an imminent prospect for the United States. Nevertheless the decline of the economy of the United States relative to other technologically advanced and high income economies over the past decade is a striking characteristic of our time. The War in the Gulf demonstrated the military might of the United States even as recent international political and economic developments, particularily the inability of the United States ,Germany and Japan to coordinate policies in the current recession, have made the diminished clout of the United States evident.

An understanding of the macroeconomic processes that can transform a successful market economy into a failed market economy should help the United States and other rich countries avoid pitfalls in economic policy. It is in no country's interest to have the enormous military superiority of the United States wedded to an economy which is failing more and more of its citizens every day.

In a general sense what is at issue for monetary and fiscal policy is for policy makers and policy analysts to recognize that modern big government capitalisms are quite different in their macroeconomic behavior through time than the pre World War 2 small government capitalist economies. The main benefits from big government capitalism are a great reduction in the likelyhood of a serious depression and the potential for the government to do useful things that a fee for service tichnique of recapturing costs cannot do well. One great danger of a big government capitalism is that the shortcomings of the economic structure are not revealed through dramantic events such as great depressions but rather through a slow decline, in which nothing that leads to general acknowledgement that what is wont do takes place.

Both Argentina and the United States are capitalist economies with complex financial structures which evolve in response to the actions of private profit seeking agents, legislative changes and administrative decisions.

The financial structure of capitalist economies are best characterized as an evolving set of liabilities, in the form of financial instruments, which are commitments by issuing agents to make payments to agents who hold these financial instruments as assets. The agents who issue financial instruments obtain the funds to meet their commitments by receiving income from the production process, by borrowing or by selling assets. If payment commitments are not fulfilled then some forfeit, as spelled out in the financial instruments, must be surrendered.

This view of the financial structure emphasizes the intertemporal cash flow characteristics of a capitalist economy. The economy's liability structure can be visualized as a set of prior commitments of future expected cash flows which are the future expected cash receipts of the units which hold these instruments as assets. Yesterdays, today and tomorrows are linked by these cash flow commitments by debtors to creditors.

Payment commitments can be dated, demand or contingent. Equity shares are financial instruments which do not require any payment of interest or the repayment of any principle outstanding. Loans and bonds are commitments to pay interest and to repay the principle. Other financial liabilities, such as insurance of various kinds, may require payment only as some contingency arises.

In a simple skeletal capitalist economy the debtor agents are firms which finance positions in capital assets, which are used in the economy's production or distribution processes, by some combination of equity shares and debts. The income that firms have available to fulfill their commitments on their debts are their gross profits after taxes. Three relations between the gross profits after taxes and payment commitments can be specified:

1. Hedge finance, where the cash flows are sufficient to meet the payment commitments,

2. Speculative finance , where the cash flows are sufficient to meet the interest payments on debts but are not sufficient to meet the contractual payments on principle outstanding, and

3. "Ponzi" finance, where the cash flows cannot fully meet

the amount due on account of interest, let alone on account of principle.

Hedge financing is presumably the desired norm. A firm which is mainly financed by equity shares is a hedge financing unit. Speculative and especially "Ponzi" finance are associated with heavily indebted ubits and economies.

A unit in a speculative finance position needs to issue new debts to meet its payment commitments. Such a unit "rolls over its debts": this situation arises when short term debts are used to finance positions in assets that have long lives. Banks, Savings and Loan Associations, Corporations which issue commercial paper, and Treasuries whch finance some of their total debt with short term bills are engaged in speculative finance. Successful speculative finance requires that financial markets function well. Central banks presumably assure that refinancing on normal market terms will be available for banks which have conformed to the rules set out by the Central bank.

A Ponzi finance unit is one that is heavily indebted relative to the cash flows it's operations yields.